FINANCE AND COMMERCE IN FEDERAL INDIA

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By

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PREFACE

AN attempt is made in the following pages to present an independent and constructive study of the various points relating to finance and commerce which will soon engage the attention of public men in Great Britain and India when a new Bill providing for the establishment of a Federation for India is presented to Parliament. All the discussions that are relevant to the subject have, as far as possible, been taken into account and it is believed that no point of any importance has been omitted. The proceedings of the two sessions of the Round Table Conference, the Reports of the Percy and Davidson Committees, the financial sections of the Lothian Committee Report, and the reports of the monetary and trade committees of the Ottawa Conference, have all been freely drawn upon and suggestions for modification made wherever considered necessary. Despite the present complications of the political situation in India, the author has worked in the earnest hope and belief that a way can be found along which the two countries can travel harmoniously together and help one another, each in its own special way, in establishing and working a constitution.

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Chapter I

TWO POINTS OF VIEW

'SO long as the Crown remains responsible for the Defence of India, the funds necessary for that purpose will have to be provided and the principal and interest on sterling debt issued in the name of the Secretary of State for India must be secured as must also the salaries and pensions of officers appointed under parliamentary authority, and as the provident and pension funds which have been fed by subscriptions from officers have never been funded but remain a floating obligation on the revenues of India, responsibility for payments to retired officers and their dependents must remain with the Secretary of State until any new Government is in a position to provide sufficient capital to enable trust funds to be established. The annual charges under these various heads will amount in the aggregate to a considerable portion of federal revenues, and for this reason it is necessary to include in the Constitution provisions sufficient to ensure that those obligations are met. This means, in effect, that the safeguards to be provided must ensure the maintenance of financial stability and credit and this, in its turn, depends upon provisions in a new budget to control the balance, that the sinking fund arrangements are adequate, that capital and revenue expenditure are allotted on sound lines, that excessive borrowing or borrowing for revenue purposes is not undertaken, and that a prudent monetary policy is consistently pursued. So far as the budget is concerned, this by no means implies that the Governor-General would control its preparation in detail. Provided the budget is properly balanced, the Federal Government can have wide discretion to decide both upon the nature

of the taxation to be imposed and upon the objects of expenditure, other than expenditure under the reserved heads.'

The above is an extract from a statement made by the Secretary of State for India on behalf of His Majesty's Government on 26th November 1931 at a meeting of the Federal Structure Committee, and may be taken to indicate roughly the conditions subject to which the British Government would be willing to transfer financial responsibility to a Federal Government within its own sphere.

Against this may be placed the Indian point of view expressed by Sir Purushottamdass Thakurdass in his speech at a meeting of the same Committee held on 24th November 1931:

'We say the finances of India should be managed by a Minister responsible to the Indian Legislative Assembly and responsible in the most complete manner. Safeguards we are prepared to accept whenever they are proved to be in the interests of India, but any safeguard regarding finance other than this cannot be conceived by us to be justified. . . . The control of finance has been admitted to be fundamental, for finance has a bearing on all the activities of government.[1] It is agreed that it is highly technical but it is a vital part of administration. . . . Any future reforms will be useless if finance is not completely transferred to us to be managed by us and by a Minister responsible to the representatives of the people in India.'

The above points of view, as so eloquently put by Mr. Pethick-Lawrence, *seem* to present 'an unbridgeable chasm between two conflicting loyalties, the loyalty of India to

[1] A similar demand for the control of finance is being made by the people of Ceylon. *Vide* the following resolution adopted by the State Council on 24 June 1932:

'This Council claims exclusive control of the public purse as the inalienable constitutional right of the people of Ceylon, and demands the immediate repeal of Articles 22, 61, 87 (1) and (4), and 91 of the Ceylon (State Council) Order in Council, 1931, as contravening that right.'

her idea of self-government and the loyalty of the British administration to its conception of trust'. But, as he went on to say, the conflict is really more apparent than real. It is really in the interest of India that her financial stability and credit in the markets of the world should be maintained at the highest level and that she should honour all her just obligations and liabilities. In the same manner, it is in the interest of Great Britain that 'confidence in the financial stability of India shall with the progress of time come to depend not on any external restraint but on the internal strength and integrity of Indian opinion'.

The discussion of the subject throughout this section proceeds accordingly on two basic assumptions:

(i) that such checks and safeguards as are recognized to be in the interests of India[1] will, during the period of transition, be accepted by India; and

(ii) that, as far as possible, these checks and safeguards should be internal in the country itself and not external or imposed upon the country by outside authority.

[1] This point is fundamental. The Indian National Congress has definitely declared its readiness to accept, during the period of transition, such safeguards as are in the interests of India. On his recent appointment as Minister of Education, Lord Irwin once again affirmed his adherence—and the adherence of the British Government and Parliament—to the pursuit of 'a policy designed to confer on the Federation of India responsibility for the management of its own affairs, subject during the period of transition to such safeguards as were found essential to the interests of India herself'. This formula provides a meeting ground for the British and Indian points of view. But, it must be admitted there are persons who think that safeguards in the interests of Great Britain must also be provided, and difficulty comes in where the interests of Great Britain and India clash, as unfortunately happens in a few cases.

Chapter II

VOTING OF SUPPLIES

IN all parliamentary systems financial control is secured by two entirely distinct processes:

(i) voting of supplies; and

(ii) granting of funds to meet those supplies.

For supplies an annual Appropriation Act, specifying the purposes and the amount voted for each purpose, is passed. The term 'supplies' covers expenditure met out of revenue, as well as capital expenditure, expenditure from borrowed funds, and all other issues from the Exchequer.

For raising moneys a Finance Act is passed annually authorizing the collection of certain taxes to cover the supplies granted. In addition, there are some permanent taxes based on statutes not liable to alteration from year to year; and, where public loans are raised, separate legislation is usually required. The essence of the arrangement is that the Executive should not be in a position to raise any funds from the people, whether in the shape of taxes, loans, or otherwise, except to the extent of the authority granted by the legislature; and that their power to spend public money should be limited (i) to purposes approved by the legislature, and (ii) to amounts as approved for each purpose by the legislature, which may not be exceeded by the Executive.

The description given above applies only to countries with a fully developed parliamentary system, like Great Britain. It can have no application to countries where the Executive is not responsible, or only partially responsible, to the legislature. The financial machinery in India to-day is naturally adapted to her political system and it must, therefore, be obvious that the introduction of a

proper parliamentary system would necessitate fundamental changes in her financial structure. But public attention is so engrossed on 'financial safeguards' that practically no thought is given to financial machinery, and the question of providing a strong and effective machinery for financial control has receded into the background. This is particularly unfortunate, as finance is of paramount importance in a poor and undeveloped country like India. The lowering of the franchise, which is inevitable and necessary, will bring into the legislatures a larger body of men pledged to greater facilities, within their respective constituencies, in the matter of communications, education, and public health, as well as to generous revisions in land revenue assessments and extinction of excise and salt revenue. The Finance Minister with a big 'No' written on his forehead will not be easy to secure in a democratic India, and he will bless a Constitution under which he can seek shelter in his natural desire to keep expenditure under control rather than invoke support from colleagues whose political commitments may occasionally run counter to considerations of economy and sound finance.

Estimates Committee.

The financial control of the Indian legislature begins with the submission of the budget estimates of revenue and expenditure, which are laid annually before both Chambers in the form of a statement, under section 67 A (1) of the Government of India Act. It is a great merit of the Indian system that income and expenditure estimates and proposals are presented to the legislature at the same time, and not as in Great Britain, where estimates of several spending departments are voted by the House of Commons even before the estimated income of the year to which those estimates relate is known. This feature should be

retained under any arrangement that may be devised for the future.

In preparing these estimates the Finance Department naturally sees that economy in expenditure is enforced on all departments of the administration. Still, to a very large degree, expenditure depends on policy and decisions on policy are taken by the Government as a whole and are not and cannot be subject to the veto of the Finance Minister. It is, therefore, felt that in addition to the scrutiny exercised by the Finance Department on behalf of the Government, there should be a further check over the estimates by a Committee of the legislature on behalf of the general tax-payer.

There is in India a Standing Finance Committee which is supposed to scrutinize the estimates shortly before the budget is presented to the Assembly. But this Committee is not a statutory body, it has no right of audience by the legislature, and whatever advice it gives is intended for the Finance Department. This is obviously unsatisfactory. The Committee should be created by statutory authority; its duties and functions should be prescribed by statute, it should be entitled to cover the whole ground, whether of detail or of policy, and to enable it really to discharge its duties in an effective manner, it should have a permanent officer attached to it whose duty it would be to do the spadework for the Committee, in much the same manner as the Auditor-General does for the Public Accounts Committee.

So far as one can judge, there is a body of opinion in Great Britain also which is in favour of revising the procedure of financial business in the House of Commons on the lines indicated above. Several letters and leading articles have recently appeared in the press on the subject to this effect, and similar evidence was given on 13th

April 1932 by Lieutenant-Colonel Sir Vivian Henderson, M.P., before the Select Committee on Procedure. Sir Vivian Henderson is Chairman of the Estimates Committee of the House of Commons and has had intimate experience of financial business in the House since 1918 in various responsible positions. His view is therefore entitled to special weight.

Discussion of Budget.

The Indian budget is dealt with by the legislature in two stages:

(1) general discussion; and

(2) voting of demands for grants.

The general discussion is a relic of the old days when no voting was permitted but members were allowed to let off steam. Its utility may now be questioned, as this discussion is generally of an academic character and centres round three or four ever-green topics, such as the reduction of military expenditure, the high scale of taxation, and the Indianization of services. It is supposed to serve three purposes. It enables the Assembly:

(i) to criticize revenue estimates;

(ii) to discuss the ways and means programme of the Government; and

(iii) to discuss non-voted expenditure.

The criticism of revenue estimates can quite effectively be made in discussions of Money Bills. The discussion of the ways and means programme is an important matter, and it is proposed in a succeeding chapter that the legislature should be given an opportunity of a more serious and effective discussion on a specific resolution requiring its approval to the whole programme. As regards (iii), it has been suggested later in this section that there should not be any non-votable items in the budget, except those

charged directly on the Consolidated Fund. Items may pertain to 'reserved' subjects, but they would not be non-votable simply because they are 'reserved'. Should, however, the view urged in these pages not meet with acceptance, it would be necessary to allot a day so that expenditure on non-votable items may be 'generally' discussed, as it would be wrong to deprive the legislature of any power now enjoyed by it.

Voting of Supplies.

The voting of supplies is at present the sole concern of the Legislative Assembly and the Council of State has no voice in the matter. The British-Indian delegates are in favour of confining this function to the Lower Chamber of the federal legislature. The Indian States delegates are of the opinion that the powers and functions of both Chambers should be equal in all respects and that this principle of equality of powers should apply also to the voting of supply.

'In their view, since the supply required by the Federal Government will be required for the common purposes of the Federation (or for the common purposes of British India), there is no logical reason which could be adduced in favour of depriving the representatives of the Federal Units in the Senate of a voice in the appropriation of the revenues, the responsibility of raising which they would share equally with the members of the other Chamber.' (Third Report of Federal Structure Committee, paragraph 42.)

If the States were to be represented only in the Upper Chamber and not in the Lower Chamber, their contention would be unrebuttable. But as they would be represented in both Chambers, and as the practice of federations is overwhelmingly in favour of the British-Indian view, stronger justification would be necessary for the introduc-

tion of an element of delay in getting through the financial business of the Federation and the curtailment of powers actually enjoyed by the Indian Legislative Assembly during the past ten years.

If the proposals of the Lothian Committee on Franchise are accepted, the composition of the two Chambers of the Federal Legislature would be as below:

	Total strength	*British-Indian quota*	*Indian States quota*
Assembly	450	300	150
Senate	200	120	80

It will be obvious that Indian States would not gain any advantage in voting strength, if differences of opinion between the two Chambers were referred to a joint session. If supply is the concern of the Assembly alone, the States would be in a minority of 150: if, however, supply is the concern of both Chambers, the States would in a joint session be in a minority of 190. In respect of financial business, it is not possible to require a majority of two-thirds of the total number or any such percentage, for business of this class cannot wait, if the requisite percentage is not secured. Decisions will have to be reached by the well-known device of a bare majority. The presumption throughout this argument is that voting will be *en bloc* by the two quotas—a very weak presumption indeed. Votes are given in accordance with one's interest, and identity of interest may lie along geographical lines. For instance, Madras and Southern India States may, on some questions, vote together rather than in opposite camps, or in regard to some other questions the interests of Panjab and the Panjab States may be the same, as against other parts of India. Moreover, there is a greater likelihood of cohesion in the Indian States contingent than in the British-Indian.

It is a common experience in politics that groups which act consistently together exercise a far greater influence in proportion to their numbers than those which do not know their own minds. Consequently, the Indian States contingent would exercise a greater influence when the majority opposed to it is smaller (if supply is the sole concern of the Assembly) than when that majority is greater (if supply is the concern of both Chambers).

Whether the voting of supplies rests with one or both Chambers, it will be equally necessary to guard the legislature against extravagance on its part, as in the case of the British House of Commons and in practically every other legislature. As Professor Keith says in his *Constitution, Administration, and Laws of the Empire*:

'The Commons, as masters in finance, are careful to safeguard themselves against improvident expenditure, no grant will be voted save on the recommendation of the Crown, that is, of the ministry, though motions may be passed urging on the House expenditure of funds on some specified object, in the hope that thus ministers will be compelled to make definite proposals, and bills come down from the Lords with italicized clauses as to expenditure, these being strictly merely waste paper. Similarly, no taxation can be proposed by any private member.'

In the Indian Constitution, section 67 A (2) of the Government of India Act provides as follows:

'No proposal for the appropriation of any revenue or moneys for any purpose shall be made except on the recommendation of the Governor-General.'

In view of the proposed transfer of responsibility in certain subjects to the Federal Legislature and the retention of responsibility in relation to other subjects by the Governor-General, it is suggested that the above provision might,

on the analogy of Article 37 of the Irish Free State Constitution, be amended somewhat as below:

'Money shall not be appropriated by vote, resolution, or law, unless the purpose of the appropriation has in the same session been recommended by a message from the Governor-General in relation to reserved subjects or the Governor-General acting on the advice of the Executive Council in relation to transferred subjects.'

'The Legislative Assembly may assent or refuse its assent to any demand or may reduce the amount referred to in any demand by a reduction of the whole grant' (sub-section (6) of section 67 A of the Government of India Act). This provision prevents the Assembly from increasing a demand and is in accordance with parliamentary practice. It should be retained in the new Constitution.

So long as Defence and External Affairs continue to be reserved subjects, the control of the legislature or the Federal Government over the estimates of these departments must necessarily be of a more or less shadowy character.

Voting by ballot on supplies and money bills.

It is a common experience not only in India but also in other countries that members of the legislature are subjected to influence in voting on financial measures by powerful interests and that they are not always able to resist such pressure. The position becomes extremely difficult when the interests of the State as a whole do not harmonize with those of such private bodies: the judgement of members leads them one way and worldly considerations pull them the other way. The Indian temperament is specially susceptible to what is called *lihâz* (regard), and it would be a great improvement if members of Indian legislatures were free to vote in accordance with their real opinion. It is therefore suggested that voting on supplies and money

bills should be by ballot and the names of members and how they vote should neither be brought on the official proceedings nor made available for general information. In making this suggestion, the writer has fully weighed the disadvantages of secret voting, but voting by ballot works successfully at general elections in India and the same considerations apply in this matter also. On balance, the suggestion, if adopted, would prove beneficial and be found to bring purity and strength to financial administration in India.

Non-votable Items.

Under the present Constitution, expenditure classified as 'defence', 'political', or 'ecclesiastical' is non-votable and only a general discussion of the estimates relating to these heads takes place in both Chambers with the permission of the Governor-General.

Expenditure relating to clerks, contingencies and travelling allowances of the Army and Foreign and Political Secretaries, is, however, put to the vote of the Assembly, as it is not classified as 'defence' or 'political', but is treated as a part of 'general administration'. In certain quarters, exception is taken to this procedure on the ground that it is improper to leave a Minister of the Crown, who is responsible for the performance of his functions to Parliament and to the electors of the United Kingdom, dependent for the supply required for the conduct of his department upon the vote of a Legislative Assembly containing a majority of members who are responsible to electors in India. Notwithstanding this so-called constitutional impropriety, it would be obviously wrong and in any case inadvisable to deprive the legislature of powers which it already enjoys in relation to these subjects.

It has been repeatedly suggested in the discussions at the Round Table Conference that the defence budget should be put on what might briefly be described as a contract basis—that is to say, a certain sum of money should be handed over to the Minister responsible for defence during a certain period and periodically this amount might be revised. This course is open to two objections. In the first place, the Assembly will be debarred from acquiring training or experience in dealing with defence questions, which it must acquire if it is ever to exercise control over defence in the future. Secondly, it is not in the interest of the general tax-payer to deprive the Finance Department of all control over defence expenditure. The splitting up of the finance of the Central Government into watertight compartments, like Railway Finance, under a Statutory Railway Board, Defence Finance, under the Army Minister or Governor-General, would practically cripple financial control, as large sums of public money would be entirely withdrawn from the supervision of the Finance Department.

There is at present no responsibility at the Centre, but in spite of this, several departmental budgets are submitted to the vote of the Legislative Assembly. Power is, however, reserved to the Governor-General to restore any rejected demand, and he actually exercises this power whenever he considers it necessary to do so. In the Provinces, Governors have similar powers in relation to demands for reserved subjects.

It is suggested that the same procedure be accepted in relation to reserved subjects at the Centre and the voting of supplies thereon. That is to say, the legislature should be allowed to vote, subject to the power of restoration in the Governor-General, in case of any rejected demand. Items charged directly on the Consolidated Fund (dis-

cussed in Chapter V) which may relate equally to reserved and transferred subjects, should, however, in accordance with the practice of the House of Commons, be excluded from the vote. The excluded items would thus be:

(i) statutory charges;
(ii) interest on public debt and sinking fund payments;
(iii) salaries and pensions of members of the higher civil and military services.

It is submitted that if the above suggestion is accepted, the position of the Minister in charge of Defence would be no worse than that of a member of the Viceroy's Executive Council to-day in relation to the Legislative Assembly or of a Member of a Provincial Executive Council in relation to the provincial legislature. The more the legislature is brought into living contact with defence expenditure, the greater the sobriety and restraint it would show in dealing with the defence budget. Stress was laid on this point by leaders of Indian opinion of all shades of thought at the Round Table Conference. What has been stated above with regard to the defence budget applies to budgets for all reserved subjects.

The demands as voted should be embodied in an Appropriation Bill, which should be submitted:

(i) to both the Chambers in case it is decided that the voting of supplies is the function of both; or,
(ii) to the Lower Chamber only, in case supplies are voted by that body alone.

The existence of an Appropriation Act will be the starting-point of financial control for the Auditor-General, so far as issues from the public treasury are concerned.

The Governor-General should have no power to restore a demand relating to a transferred subject after it has been refused by the legislature.

The power vested in the Governor-General under sub-

section (8) of section 67 A of the Government of India Act to authorize expenditure in cases of emergency should obviously be retained, in view of the obligation which would still rest on him to ensure the safety and tranquillity of the country.

It is also suggested, in Chapter VIII, that the power at present vesting in the Governor-General under sub-section (4) of section 67 A of the Government of India Act to decide whether any proposed appropriation of revenue or moneys does or does not relate to a non-votable head should be transferred to an impartial and expert authority like the Auditor-General. The retention of this power in the hands of the Governor-General would give rise to unnecessary friction and dissatisfaction.

Administrative Sanction to Expenditure.

The legislature in voting supplies only makes funds available, or, as they say in technical language, only accords financial sanction, which does not dispense with the necessity for the officer incurring the expenditure to obtain the sanction of the competent administrative authority. Under the existing Constitution, the source of all administrative sanction to expenditure from Indian revenues is the Secretary of State in Council, under section 21 of the Government of India Act. This provision will have to be very considerably modified in the new system. So far as expenditure from provincial revenues is concerned, the final authority for all administrative sanction should be the provincial Government. Similarly, for transferred subjects in the Centre, the Federal (or Central) Government should be the final authority. In relation to reserved subjects at the Centre and expenditure authorized by provincial Governors or the Governor-General in the exercise of their special powers and on their own responsibility, the

control of the Secretary of State should be retained. The authorities in India should be subject to some control, whether from above or from below. To the extent they are subject to control by the legislatures in India, they must be released from control by Whitehall and Westminster, as they obviously cannot serve two masters. *Per contra*, to the extent they are free from control in India, they must continue to be subject to external control by the Secretary of State for India, or the British Parliament, as the case may require.

Chapter III

MONEY BILLS

UNDER section 63 of the Government of India Act, Money Bills, like other Bills, require the assent of both the Chambers of the Indian legislature. The British Indian Delegates at the Round Table Conference were of the view that the right of initiating Money Bills should vest in the Lower (or popular) Chamber alone, though the States Delegation were opposed to the drawing of this distinction and were in favour of giving equal powers, as at present. Two Chambers with equal powers over taxation cannot work in harmony, for if two persons ride together, obviously one must ride in front. As the Federal Structure Committee themselves admit in their report, 'the evolution of political development will inevitably result, in the course of time, in placing the centre of gravity in one chamber'. And it needs no great political foresight to see which of the two this 'one chamber' will be.

The relations between the Indian Legislative Assembly and the Council of State during the past ten years have been far from harmonious. As related by a member of the Council of State at a meeting of the Federal Structure Committee last year, 'there are many Members of the Assembly who share the view that the Council of State is a defunct, superfluous, decrepit body, and that it consists of men of no consequence'. Sir Tej Bahadur Sapru stated that the view of the Government of India, if their secret dispatches were looked up, would also be found to be that 'if there is one branch of the legislature in India which has failed to produce any impression on the public mind, it is the Upper Chamber'.

The Council of State has come into serious conflict with

the Legislative Assembly over Finance Bills in 1923, 1924, and 1931, and the Legislative Assembly has, on several occasions, contested the right of the Council of State to deal with Money Bills, on the ground that as the Assembly alone is competent to grant supplies, it alone should be competent to decide what funds should be granted to cover those supplies. This position has not been accepted by the Government of India. The constitutional history of England is full of struggles over Money Bills between the House of Commons and the House of Lords, which eventually resulted in the triumph of the former. Constitutions of self-governing Dominions also recognize that power in money matters must reside in the Lower House.

In describing the functions and procedure of the Dominion Parliaments, Professor Keith says:

'The predominance over the administration of the Lower House is secured by its sole initiative in matters of finance.' (*The Constitution, Administration, and Laws of the Empire*, page 219.)

This general observation may easily be illustrated by a reference to the Constitution Acts of the Dominions.

Section 53 of the Canada Act enacts as follows:

'Bills for appropriating any part of the public revenue, or for imposing any tax or impost, shall originate in the House of Commons.'

Similarly, section 53 of the Australia Act provides as follows:

'Proposed laws appropriating revenue or moneys or imposing taxation, shall not originate in the Senate. But a proposed law shall not be taken to appropriate revenue or moneys, or to impose taxation, by reason only of its containing provisions for the imposition or appropriation of fines or other pecuniary penalties, or for the demand or payment or appropriation of fees for licenses, or fees for services under the proposed law.

'The Senate may not amend proposed laws imposing taxa-

tion, or proposed laws appropriating revenue or moneys for the ordinary annual services of the Government.

'The Senate may not amend any proposed law so as to increase any proposed charge or burden on the people.

'The Senate may at any stage return to the House of Representatives any proposed law which the Senate may not amend, requesting, by message, the omission or amendment of any items or provisions therein. And the House of Representatives may, if it thinks fit, make any of such omissions or amendments with or without modifications.

'Except as provided in this section, the Senate shall have equal power with the House of Representatives in respect of all proposed laws.'

In the case of South Africa, the relevant section is section 60, which enacts as follows:

'(1) Bills appropriating revenue or moneys or imposing taxation shall originate only in the House of Assembly. But a Bill shall not be taken to appropriate revenue or moneys or to impose taxation by reason only of its containing provisions for the imposition or appropriation of fines or other pecuniary penalties.

'(2) The Senate may not amend any Bills so far as they impose taxation or appropriate revenue or moneys for the services of the Government.

'(3) The Senate may not amend any Bill so as to increase any proposed charges or burden on the people.'

Then section 61 says:

'The House of Assembly shall not originate or pass any vote, resolution, address, or Bill for the appropriation of any part of the public revenue or of any tax or impost to any purpose unless such appropriation has been recommended by message from the Governor-General during the Session in which such vote, resolution, address, or Bill is proposed.'

Private Money Bills.

Just as the initiative in regard to expenditure rests by law with the Executive Government, it is necessary that

the initiative in regard to increases of taxation should also vest by law in the same authority.

There is no definite statutory provision in the Indian Constitution on the subject, as in the case of expenditure, but the presidents of the two Chambers of the Indian legislature have ruled that 'the Crown makes a demand, the Crown proposes taxation, the legislature can reduce the demand or the taxation, but it can neither increase the demand nor can it increase the taxation, except at the instance of a member of the government'.

It would be desirable to have such a provision in the new Constitution, if a suitable clause to this effect could be framed.

Government Money Bills.

So far as the Government itself is concerned, under section 67 (2) (*a*) of the Government of India Act, it is not lawful, without the previous sanction of the Governor-General, to introduce at any meeting of either Chamber of the Indian legislature any measure 'affecting the public revenues of India'.

It was pointed out during the debates that the previous sanction of the Governor-General is inconsistent with the principle of responsibility of the Executive and is unknown to Dominion Constitutions. The Executive should be free to propose any measure on its own responsibility, the Governor-General having the power of reservation or disallowance after the measure has been dealt with by the legislature. It would be of interest to note that the Ceylon Legislative Council only a short while ago passed without a division a resolution stating that 'the provision for requiring the previous consent of the Governor or the Secretary of State for any class of legislation is objectionable in principle and calculated to subvert the authority of the legislature and should be withdrawn'.

Taxation by Executive Action.

It is necessary to refer at this stage to the fact that under the present Constitution, as was pointed out by the Joint Select Committee on the Government of India Bill, 1919, certain classes of taxation can still be laid upon the people of India, by executive action, without, in some cases, any statutory limitation of the rates and in other cases, any adequate prescription by statute of the methods of assessment. This is a grave defect and should be remedied in the new Constitution, either by provision as a fundamental right or in any other manner. It should be specifically provided that all public taxes and imposts must without exception be authorized by law; and that no action in relation to imposition, alteration, or abolition of any taxation or imposts may be taken save in pursuance of law. This provision exists in several constitutions, such as those of Czechoslovakia (Article 111), Belgium (Article 110), Poland (Article 6), &c.

Certification of Money Bills.

In view of the fact that private members of the legislature can propose reduction or abolition of taxation when money bills come up before the legislature, it is necessary to consider what provision should be made in case a Finance Bill (or any other Money Bill) is either wholly rejected or so mutilated as to prove inadequate to meet the needs of all the public departments for any year. Such a contingency has arisen in the past and has been dealt with by resort to the power of certification which the Governor-General possesses under section 67 B of the Government of India Act. The exercise of this power naturally causes dissatisfaction, but in constitution-making, as in every human endeavour, while hoping for the best, one must provide for the worst.

So long as the Governor-General is responsible for the administration of reserved subjects and for meeting 'first charges' on the proposed Consolidated Fund,[1] he must be empowered 'to implement his decisions if occasion so demands by requiring appropriation of revenue to be made, or by legislative enactment' (Second Report of the Federal Structure Committee, paragraph 16). This is fundamental.

It would indeed be too heavy a responsibility for the Governor-General to meet charges amounting to 80 per cent.[2] of the net revenues of the Government without being given power to ensure that the money required is actually in the till.

If the history of the struggle during the last ten years between the Assembly and the Government over Finance Bills points to any moral it is this. So long as there are large non-voted items, taxes will be refused not on their merits or demerits, but in order to force a reduction in non-voted expenditure. And this attitude may be expected to continue, and even gain in intensity and volume as time goes on, until the whole budget is thrown open to the vote.

As an alternative to certification, it has been suggested that India might adopt the provision in the Japanese Constitution, that in the event of the rejection by the legislature of the Government's proposals for the raising of revenue in any given year, the provision made for the last financial year should continue automatically to be operative. This suggestion leads to the same result as certification and may be adopted.

[1] This is discussed in Chapter VI in this section.

[2] This is the estimate of the charges in question: *vide* Chapter VI.

Chapter IV

CAPITAL, DEBT, AND REMITTANCE TRANSACTIONS

IN addition to moneys raised through taxation, there are large sums received and paid by Government, under what are known as Capital, Debt, and Remittance heads in the national accounts. A brief preliminary explanation of these heads will, it is hoped, not be regarded as out of place.

Capital receipts consist mostly of receipts from sales of Crown property, and such other extraordinary and special receipts which cannot be credited to revenue. Expenditure charged to the capital account is usually expenditure from loan funds for productive public works or other large works, whose benefits are of a more or less permanent character. Debt head receipts and payments consist of receipts and payments on accounts of loans, postal cash certificates, savings bank and provident fund deposits, &c.

'Remittance' receipts and payments consist mostly of receipts and payments on account of Sterling Bills, money-order transactions, &c.

In England, His Majesty's Government act under statutory sanction for all loans, permanent or temporary, raised by them. The Secretary of State for India, being a member of His Majesty's Government, gets authority from time to time from the British Parliament for sterling loans raised by him on behalf of India. There exists a whole series of East India Loan Acts ever since such operations began.

The Government of India, are, however, free to borrow money in India without authority either from the British Parliament or the Indian legislature. They, of course, obtain the approval of the Secretary of State to each such issue.

This is an anomalous position. All loans on the security of the revenues of India, whether raised in India or outside, should be based on authority derived from the Indian legislature. So far as rupee loans are concerned, there ought to be no difficulty. So far as sterling loans are concerned, it is said that if the existing parliamentary restrictions on Indian loans were abolished, Indian Sterling Securities would automatically cease to be trustee securities under the Trustee Act, and in order to keep them in the category of trustee stock, Government would have to secure legislation in the United Kingdom on the lines of the Colonial Stock Act of 1900. There is no reason why this should not be done by His Majesty's Government for India, as Dominion Governments are not required to obtain parliamentary sanction for loans raised by them in London and their stocks enjoy the benefits of trustee securities on the fulfilment of certain conditions.

In view of the fact that by fulfilling such conditions, Dominions can raise loans at a cheaper rate of interest, they do so gladly, and so would India if she desired to enjoy such a benefit. The High Commissioners for the various Dominions negotiate loans for them in London. So should the Indian High Commissioner do for India. This point will be dealt with in connexion with loans in a subsequent chapter. At this stage only the following points need to be stressed:

No loan should be raised nor should any expenditure be incurred from loan funds except with the approval of the Indian legislature.

For estimates of receipts and disbursements under capital, debt, and remittance heads the approval of the legislature should be obtained by moving resolutions at each budget session.

Chapter V

CONSOLIDATED FUND CHARGES

IT is a common feature of modern constitutions to secure control over public revenues by putting them into one Consolidated Revenue Fund and limiting their appropriation to purposes and amounts sanctioned by the legislature. By such a provision it becomes illegal for a public servant receiving public moneys to keep them out of the consolidated fund account. Defalcation and misapplication are thus prevented. Once the money goes into the fund, it cannot be drawn out except to the extent and for purposes authorized by law, for which in several countries a certificate of the Audit Officer has to be obtained on each occasion by the drawing authority.

In India there is at present no Statutory Consolidated Revenue Fund. But under a statutory rule (Devolution Rule 16) it is provided that 'all moneys derived from sources of provincial revenue shall be paid into the public account of which the Governor-General-in-Council is custodian'. Out of this 'public account' the Governor-General-in-Council is authorized to make grants or appropriations in accordance with the provisions or restrictions prescribed by the Secretary of State in Council. It will, however, no longer be possible to require the provinces to pay their receipts into one Central Consolidated Revenue Fund. When provinces become autonomous they will have their own Consolidated Revenue Funds and the Federal (or Central) Government will have a separate fund of its own.

Assistance in the establishment of a Statutory Fund for India might be obtained from the following provisions in the Australian Constitution:

'*Section 81*. All revenues or moneys raised or received by the

Executive Government of the Commonwealth shall form one Consolidated Revenue Fund, to be appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities imposed by the Constitution.

'*Section 82.* The costs, charges, and expenses incident to the collection, management, and receipt of the Consolidated Revenue Fund shall form the first charge thereon; and the revenue of the Commonwealth shall in the first instance be applied to the payment of the expenditure of the Commonwealth.

'*Section 83.* No money shall be drawn from the treasury of the Commonwealth except under an appropriation made by law.'

First Charges on the Consolidated Fund.

The main advantage arising from the establishment of a Consolidated Fund is that by making certain items as 'first charges' on the fund they are withdrawn from the annual vote of the legislature. This is a restriction on the powers of the legislature and can be defended only in cases of proved public necessity. It consequently becomes necessary to see what such 'first charges' should be in the case of India.

(*a*) *Statutory Charges.* So far as charges authorized by statute are concerned, there would be general agreement that they should not be subjected to the annual vote. This is the recognized practice in all countries.

(*b*) *The Public Debt.* The public debt also stands in a similar category. In the Dominions also public debts are treated in this manner. For instance, section 119 of the South African Constitution provides as follows:

'The annual interest of the public debts of the Colonies and any sinking funds constituted by law at the establishment of the Union shall form a first charge on the Consolidated Revenue Fund.'

Similar provision is to be found in section 104 of the Canadian Constitution.

(*c*) *Salaries and Pensions of Government Servants.* In relation to existing incumbents of the higher services, civil and military, whose terms of service are guaranteed by the Secretary of State, and officers to be recruited in future by the Secretary of State for reserved departments, charges on account of their salaries and pensions (at present non-votable) may be placed on the Consolidated Fund. Sir Tej Bahadur Sapru made this point quite clear:

'As regards pensions, which are in being, or which are maturing, or the salaries or emoluments of the Services, take it from me there is absolutely no desire to rob any one of a single penny. You have protected those pensions under the present Government of India Act, and frankly I do want the pensions and the salaries and the other allowances of the services to be protected.'

That there exists uneasiness among the members of the higher services about the safety of their pensions and considerable misgiving as to what the future holds in store for them cannot be gainsaid. The same question arose, though in a milder form, when the Montagu-Chelmsford reforms were on the anvil. Recent wild talk of repudiating India's external obligations has given this feeling greater intensity, though, as has been emphasized above, no sane person has made such a suggestion. Indian opinion is in agreement with Sir Tej Bahadur Sapru that pensions and salaries should be protected. But it is impossible to meet the apprehensions of some pessimistic members of the services who foresee a time when cut adrift from effective British control, India's finances may deteriorate to such an extent that with the best will in the world she may not be able to meet the liability for pensions and other external obligations. The implication of such a foreboding cannot

be that the transfer of finance should be postponed till the pensions of all the existing members are exhausted. It is equally difficult to provide, as is sometimes asked, that the retiring members of the services should be entitled to get the whole of their pension commuted into a single payment. This, with the best intentions, may not be found feasible on financial grounds, if demanded by a large number of officers simultaneously. They also ask that family pensions and provident funds be either placed in the charge of the Public Trustee in England or of trustees appointed by the Secretary of State. As these funds are more or less the property of the officers themselves, there is no objection to the suggestion being given effect to, so far as *annual charges* on these funds are concerned. It will, however, not be possible, as suggested in the extract from Sir Samuel Hoare's speech quoted in the beginning of Chapter I, for any Indian Government 'to provide sufficient *capital* to enable Trust funds to be established'.

Proportion of 'First Charges' to Net Revenues.

It will be observed that the total budgets for the reserved departments are not proposed above for inclusion in the list of 'first charges' on the Consolidated Fund. In these departments, as in others, the salaries and pensions of officers appointed under parliamentary authority would be non-votable. But other expenditure would, if the suggestion made in Chapter II is accepted, be open to the vote. This is, however, not the view that prevails. According to this view, all expenditure on reserved subjects should be non-votable. On this basis, the first charges would roughly be as under:

	(Rupees)
Defence	47 crores
Debt Services	15 ,,
Salaries and Pensions	10 ,,
Total	72 crores

The net revenues of the Government of India amount to about 90 crores. The 'first charges' thus amount to very nearly 80 per cent. of the net revenues. It would be extremely difficult to secure the agreement of India if such a large percentage of the public revenues were withdrawn from the purview of the legislature. The point is of a vital character, and unless a reasonable concession is made the reforms will fail. It is in this belief that the suggestion to throw open the reserved department budgets to the vote, subject to power of restoration in the Governor-General, is made in Chapter II. The effect of this suggestion would be to reduce the 'first charges' from 72 to about 32 crores.

Chapter VI

LOANS

SO far as existing loans are concerned, provision can be made in the constitution for making interest and sinking fund payments and repayments of principal as a first charge on the Consolidated Fund. As more than half the national debt is held by Indians, it would be cutting one's nose to spite one's face if action were taken by any Indian Government which endangered the safety of holders of Government securities or affected the credit of India in any manner, and particularly so in regard to rupee securities.

It is, however, stated that the British Government owes a special responsibility to those who have invested their money in sterling loans, as these amounts have been raised by the Secretary of State under Acts of Parliament and that had the investors any idea that at some future date the British Government would hand over its responsibility to an Indian Government, they would not have so readily come forward to give those moneys to the Secretary of State.

This demand is said to be based on the ordinary rule of daily life that if a person lends money to another on an estate and he hands over the estate to some one else, the creditor is entitled to ask for fresh or further guarantees.

It is further stated that the security of the investor in sterling loans would be diminished if loans were raised by the Indian Government in the future at extravagant rates. For this reason it is not only necessary to secure the existing sterling loans, but also to retain some control over the raising of external loans in the future.

It is not suggested that the Indian Government of the future would deliberately damage the credit of India in the

London money market. But all the same, it is said that in these matters it is not the politician who has to be satisfied but the man of business who distrusts changes of system, and that there would be nervousness in the mind of the British investor if under the new dispensation the financial link between the United Kingdom and India were suddenly severed. The successive defaults on loans raised by so many foreign governments in London, involving, it is said, no less than 145 million pounds[1] of British money, and the defaults much nearer home by the present Government of Southern Ireland, have, it is alleged, added largely to this feeling of nervousness.

It has therefore been suggested that some control is necessary with a view to ensuring that:

(i) loans are not raised to meet budget deficits; and

(ii) loans are not raised at extravagant rates.

In regard to the first condition, everybody understands that it is unsound finance to meet a budget deficit by a loan, instead of by extra taxation. But to require the Federal Government to seek external sanction for loans when a budget deficit may become unavoidable is going a little too far.

The Government of India itself has had successive budget deficits for five years ending 1922–3 which aggregated about 100 crores and for the last eleven years there were uncovered deficits amounting to something like 56 crores. What has happened in the past might happen again in the future, and it is possible that in extraordinary circumstances the Finance Minister of the future may have temporarily to cover one or two or three budget deficits by loans.

For such eventualities no safeguard is necessary. It is

[1] Figures taken from paragraph 36 of *Industry and the Empire*—a memorandum prepared by the Federation of British Industries.

certainly possible to provide that if the responsible Minister fails to produce a balanced budget the Governor-General shall have the power to impose additional taxation, either by ordinance or by certified enactment. But this would not improve matters. It might lead to constitutional complications and deadlocks.

'The greatest safeguard will lie in the fact that responsibility will be vested in a body of men who will answer for their misdeeds to another body of men who will represent all sections of the community which will suffer seriously from their misdeeds.' (Sir B. N. Mitra.)

Indian investors may be trusted to see that the Finance Minister does not pursue a reckless policy of borrowing.

With regard to raising of loans at extravagant rates, the Government of India itself was obliged by post-war conditions to float loans in India on terms which have led to a very severe capital depreciation in 3 and 3½ per cent. rupee paper, and they have withstood all demands for compensation to holders of such securities. The face value of these securities amounts to Rs. 125 crores, and their market value to-day would hardly be 60 crores.

If the Federal Government, under the pressure of extraordinary circumstances, is obliged to offer more attractive terms than are offered by the Government of India to-day, there is no reason why its power should be curtailed or its freedom of action impaired by requiring it to obtain the sanction of any external authority.

With regard to future sterling loans, if India wants to retain the benefits attaching to trustee securities under the Trustee Act, it is only just and proper that she should conform to the requirements of that Act and satisfy the British Government that it has got enough security against which the loan can be issued. Each Government must obviously retain the right to prescribe the conditions under which

stocks issued by other Governments within its own jurisdiction carry the privilege of admission to the trustee list. But should India not desire to enjoy the benefit attaching to trustee securities, she should not be compelled to do so. Let her approach the London market unaided and when she finds that the British investor either refuses to lend without the intervention of the Secretary of State or will not do so except under very onerous conditions, she will herself ask for such help from the British Government as circumstances may seem to require.

It is customary for Finance Ministers to take the advice of financiers and bankers before putting loan issues on the market. The Indian Finance Minister would in the ordinary course consult the Imperial Bank or the Reserve Bank, when established. Should, however, this be not deemed a sufficient safeguard, it may be provided that the terms of any future loan, internal or external, should be approved by the Central Loan Council—the establishment of which is suggested in the section on federal finance, in connexion with the co-ordination of federal and provincial borrowings. Further, it might be provided, on the analogy of Article 87 of the German Constitution, that loans shall not ordinarily be raised except for productive purposes.

Chapter VII

EXCHANGE AND CURRENCY

THE transfer of finance to the control of the Indian legislature involves the transfer of control over exchange and currency, which are at present managed by the Government, in the absence of a duly constituted Central Bank. The management of currency and exchange by Government in any part of the world would not be regarded with approval: in India there are special reasons why such management is regarded with distrust and suspicion. As Sir Ernest Hotson, with intimate knowledge of the views of the Indian trading and mercantile community, recently stated at a meeting of the East India Association, Indian merchants have for years past believed that in fiscal matters the interests of Lancashire and the City of London weigh far more with the Government than the interests of India. In Great Britain, on the other hand, there is a genuine apprehension that the control of currency and exchange policy, when transferred to Indian hands, would give politicians an easy means of damaging British trade and industry, and that manipulation of the currency would be resorted to to cover budgetary deficits and unsound methods in public finance.

It is not the purpose of this book to deal with the general question, or the past history, of Indian currency and exchange. That would be much too wide a theme for discussion here. We are only concerned with such aspects of the problem as must be taken into account in including currency and exchange as a transferred subject in a Government of India Bill. What India asks for is that she should be free to decide what she considers to be the right policy for the country in matters of currency and exchange,

in the same manner as Canada, South Africa, and Australia do to-day. At the time of writing, compared with the English pound sterling, the Australian pound is at a discount of 25 per cent., the New Zealand pound is at a discount of 10 per cent., the Canadian dollar is at a premium of 10 per cent., and the South African pound is at a premium of 25 per cent. The Indian rupee alone, of the currencies of the larger countries of the Empire, is pegged to sterling. In relation to South Africa, there is acute controversy regarding her decision to stick to the gold standard, which persons in Great Britain think is a wrong decision. But, as *The Times* pointed out quite recently, 'the South African Government is clearly within its rights in maintaining the gold standard; whether the expected ultimate advantage is being bought too dearly is not for any one outside the Union to say'. India also asks that she should be equally free to make mistakes and purchase her own experience.

There is no doubt that monetary policy has a far-reaching effect and may do more to affect the course of trade and industry than a trade agreement or an application of the tariff and without creating so much noise. Any trade or tariff preference may be neutralized by a deliberate depreciation of the currency; so also may the restrictive effect of a high tariff be counteracted by an appreciation of the currency. Constant fluctuations in exchange make trade and enterprise a pure gamble and inflict serious and undeserved losses on all sections of the community. There will be general agreement that it is essential to ensure 'that a prudent monetary policy is consistently pursued' by the Federal Government—*vide* the statement of policy of the British Government quoted in the beginning of Chapter I. That seems to be the only requirement from the British point of view.

The question of monetary policy was discussed at the Ottawa Conference. It was at one time feared in India that the Indian Delegation, considering its composition, might be obliged to join a 'sterling area' and commit India to a policy of maintaining the rupee at its present ratio with sterling, which is unpopular in India. That would have necessitated India making a contribution from its sterling currency assets towards a Central Exchange Pool, to be virtually managed by the Bank of England. But, fortunately, no such decisive step was taken at Ottawa. There is nothing in the monetary resolutions of the Ottawa Conference to which exception can be taken, and there is no commitment with regard to future policy. That stabilization of the exchanges is highly desirable, that there should be a satisfactory international monetary standard, that a substantial rise in prices is urgently necessary (which, it is recognized, cannot be brought about by monetary action alone), &c., are all propositions which India can accept most readily. They would leave her perfectly free to link her currency to gold, sterling, silver, or any other standard she preferred, and equally free to adopt any exchange-ratio she considered suitable.

What are then the steps necessary to ensure the consistent pursuit of a 'prudent monetary policy', such as is desired by the British Government?

The first step is to set up a Central Bank in India and entrust to it the day-to-day management of the currency. Such a step would have been necessary even if the question of transfer of responsibility for currency and exchange had not arisen. The present position is regarded as unsatisfactory even by Government themselves. Sir George Schuster recently admitted that so long as the Government of India was the currency authority also, not only would it be easy for their critics to say that currency policy was dictated by

revenue considerations but that Government were put into the unfortunate position that fluctuations in their receipts as currency authority reacted upon and upset the budgetary position. The Reserve Bank Bill of 1927 was wrecked on the question of composition of the directorate. Now, with the participation of Indian States in the Federation, this question would assume a new complexion and possibly the old difficulties may not arise. As Sir Basil Blackett suggested, this might be one of the first institutions to be set up under the Federation and might well be called the Federal Bank of India.

But in addition to the question of composition of the directorate, there are other points which must be settled before the Bank could be entrusted with the management of the currency. The rupee-sterling ratio must necessarily be stated in a Reserve Bank Bill, which will raise the old controversy once again, unless some agreement with Indian opinion is reached in the interval. The reconsideration of the ratio would raise the connected question whether the Indian currency should be linked to sterling, or to gold or any other standard. And this question obviously cannot be decided until world conditions improve and the situation with regard to the selection of an international monetary standard becomes more clear and definite.

In view of the dependence of India on sterling in regard to foreign trade and public finance, she will in any case have to have substantial sterling assets in her currency reserves. What reserves would be regarded as adequate is a matter on which no opinion can at present be expressed. The decision will necessarily be governed by the circumstances prevailing at the time. All that can be said now is that India's position in relation to sterling assets is much stronger than at any time during the last two years.

Indian opinion is in favour of the establishment of a Reserve Bank, as soon as this can be done. It, however, insists that:

(i) it should be free from interference from the executive or the legislature, Indian or British, in its day-to-day administration;

(ii) it should be established by an Act of the Indian Legislature;

(iii) while its personnel should command the confidence of the banking world, it should be under national control in the same manner as Central Banks in other countries; and

(iv) it should not be tied down to work on lines approved by the Bank of England. India should be free to take advice and guidance of any institution it likes. For instance, if it is found in the Indian interest to work on the lines of the American Federal Reserve Bank (rather than on the lines of the Bank of England) she should be free to do so.

If a Reserve Bank could be established immediately, both British and Indian opinion would be satisfied and the transfer of the control of exchange and currency policy to the Federal Government would present no difficulty. But as the establishment of a Reserve Bank must, for the reasons given above, take some time, it is necessary to consider what *ad interim* arrangement can be made, as the transfer of the subject of exchange and currency is regarded as essential by India. The Federal Structure Committee in paragraph 18 of its Report dated 13th January 1931 suggested that provision should be made in the Constitution requiring the Governor-General's previous sanction to the introduction of a Bill to amend the Paper Currency or Coinage Acts on the lines of section 67 of the Government of India Act. In the first place, there is no

need for a permanent safeguard of this kind. Secondly, objection is taken by Indian opinion to the Governor-General's previous sanction, which, as already stated, is considered inconsistent with responsibility in the Executive. More deserving of consideration is the suggestion that pending the establishment of a Reserve Bank a Statutory Advisory Council should be created which would advise the Finance Minister and the Governor-General regarding currency and exchange policy. This Council, it is proposed, should consist of British and Indian experts, selected so as to secure the confidence of both Great Britain and India. If this suggestion meets with the approval of all parties, it will be necessary to provide that the constitution of the Council is such that it does not hamper the Finance Minister in the discharge of his responsibilities to the legislature and that it is abolished as soon as a Reserve Bank is established.

Chapter VIII

ORDERLY FINANCE

THE enforcement of economy in public expenditure by hard and fast rules is almost impossible, and, so far as human experience goes, the only feasible method by which this very desirable end can be achieved is by insisting on regularity in the spending of public money. Gladstone first embodied this idea in the financial system of Great Britain in his Exchequer and Audit Departments Act of 1866, and since then other countries have followed the example of England. It is only natural, when India is building up a parliamentary system, that she should have the best machinery for financial control under the new conditions that are being set up. We have, therefore, to turn for guidance to the provisions of the Exchequer and Audit Departments Act now in force in Great Britain and to see how far they can be adopted in India.

The first thing that strikes one in comparing the English and Indian systems is the absence in India of a statute defining the duties and functions of the Auditor-General. There is just a brief reference to the Auditor-General in section 96 D of the Government of India Act, but his duties and functions are defined in rules framed by the Secretary of State in Council under the Act, which are known as the Auditor-General's Rules.

The second striking difference is the absence in India of an Exchequer Department. In England, the Comptroller and Auditor-General performs two functions. He is the Comptroller-General of the receipts and issues of His Majesty's Exchequer as well as Auditor-General of the public accounts. In India, the Auditor-General has nothing to do with receipts and issues of the Exchequer. His

main concern is with expenditure. As Comptroller-General of the Exchequer, the English Comptroller and Auditor-General is directed by the Exchequer and Audit Department Act to grant credits from time to time on the requisition of the Treasury, for issues from the Consolidated Fund, both for services charged directly on that fund by Act of Parliament, such as interest on the National Debt, the King's Civil List, Judges' salaries, &c., and also for Supply Services to be accounted for in the Annual Appropriation Accounts. Before doing so, he is required to satisfy himself that such credits are not in excess of the sums granted by the various Acts of Parliament. All warrants for the preparation and issue of Exchequer Bonds and Treasury Bills are required to be countersigned by the Comptroller and Auditor-General or the Assistant Comptroller and Auditor. A daily account of the receipts into and issues from the Account of the Exchequer in the books of the Bank of England is furnished to him by the Bank. The Revenue Departments forward a daily statement of the accounts paid by them into the Exchequer.

In India there is no statutory control by the Audit Department over issues from the public treasury. If a system of Exchequer Issues, modified to suit Indian conditions, were adopted, there would be a more complete and better financial control over payments. It is far easier and simpler to control irregularity in the spending of public money by stopping issues from the Treasury than by crying over spilt milk after the money has been taken out of the Treasury and spent. As a form of financial safeguard, the system of Exchequer Issues has great value, for it takes the control of public money out of the hands of the administrative authorities and places it in the hands of an independent and impartial authority which has no interest in the objects to which the money is to be applied. Once a

budget is passed making provision for all charges legitimately payable out of the Consolidated Fund, the Governor-General would, in the event of this suggestion being adopted, have the satisfaction that no authority could touch the fund or operate on it in such a manner as to leave an insufficient margin for payment of amounts charged directly on the Consolidated Fund.

Secondly, the Auditor-General should be given authority over all expenditure from Indian revenues, whether such expenditure is incurred in India or outside India. At present, there are two independent Auditors for expenditure chargeable to Indian revenues. For expenditure in India, there is the Auditor-General appointed by the Secretary of State in Council under section 96 D of the Government of India Act. For financial transactions in the United Kingdom, there is a separate Auditor appointed by His Majesty under section 27 of the Government of India Act, who is independent of the Auditor-General in India. Whereas the position of the Home Auditor (as he may be called for brevity) is defined at fairly great length in section 27 of the Act, the powers and functions of the Auditor-General are derived from statutory rules framed by the Secretary of State in Council which can be altered by that authority at any time. This is anomalous and should be put right. The powers and functions of the Auditor-General should be laid down, as in England, in an Exchequer and Audit Departments Act, and he should have cognizance over all financial transactions, whether in India or outside. The Home Auditor should be in the position of his deputy.

Thirdly, whereas the English Auditor-General, under section 2 of the Exchequer and Audit Departments Act of 1921, exercises scrutiny over accounts of receipt of revenue and is entitled to see that adequate regulations and pro-

cedure have been framed to secure an effective check on the assessment, collection, and proper allocation of revenue, and that such regulations and procedure are being duly carried out, the Auditor-General in India is mainly responsible for audit of expenditure and has no such scope in relation to accounts of receipts. The scope of audit should be enlarged on the same lines as in England.

Even the Home Auditor has a wider scope than the Auditor-General in India. In fact, the duties of the Home Auditor are practically the same as of the English Comptroller and Auditor-General. Sub-section 2 of section 27 of the Government of India Act defines the functions of the Home Auditor in the following terms:

> 'The Auditor shall examine and audit the accounts of the receipt, expenditure, and disposal in the United Kingdom of all money, stores, and property applicable for the purposes of this Act.'

Fourthly, the Auditor-General should be responsible as regards transferred subjects to the Indian legislature in exactly the same manner as the English Comptroller and Auditor-General is to the House of Commons. For reserved subjects, the Auditor-General would be responsible to the Secretary of State in Council during the period of transition.

Fifthly, the Auditor-General should be the final authority not only for the correct classification of items in the accounts, but also for the allocation of expenditure (in budgets and accounts) as between revenue and capital. It would be more appropriate if he were also the final authority to decide, in cases of dispute, whether any item was reserved or transferred, votable or non-votable. At present the Governor-General is empowered to give a

decision on such an issue, but it would manifestly be inappropriate to continue this arrangement when responsibility at the centre is divided. In his new capacity, the Governor-General would be responsible for the administration of reserved subjects and would therefore be more interested in them than in the administration of transferred subjects. His responsibility with regard to 'first charges' on the Consolidated Fund would also be of a special character. To prevent friction and dissatisfaction, it is necessary that the decision in cases of either class should come from an impartial authority. There would be only two such authorities in Federal India: the Auditor-General and the Federal Court. A reference to the Federal Court would undoubtedly be more satisfactory and more in accord with the functions of the Court in relation to interpretation of the constitution generally. But issues of the type mentioned above would be fairly numerous and would usually be connected with matters of day-to-day administration, with which the Auditor-General would be better acquainted. There would also be great delay in securing decisions from the Court. On purely practical grounds, it seems better to empower the Auditor-General to decide such issues.

Sixthly, it would be a great help to clean and straightforward finance if the Auditor-General were required by statute to append a review of the financial position of the Central Government in his annual appropriation and audit report. Such a review by an independent and impartial authority would be of great value and would tend to bring before the public features which might not otherwise be brought to notice by the Executive Government itself. This duty is already performed by the Auditor-General so far as provincial governments are concerned. Only lately, the Auditor-General reported to the provin-

cial Public Accounts Committee that financial administration in Bombay Presidency had fallen far short of a high standard of efficiency and was ineffective, and that the financial position of the province afforded ground for grave anxiety. Criticism of this kind coming from such a source would supply the needed stimulus and corrective and probably render resort to extraordinary measures by the Governor-General unnecessary. If repeated criticism of financial administration by the Auditor-General remained unheeded, public opinion would support any exceptional measure which the Governor-General might be forced to take to put the finances right.

Seventhly, in order that pressure of public opinion may be brought to bear on weak spots in the financial administration, it is essential that the proceedings and reports of the Central Public Accounts Committee should be available to the public, which, it is understood, is not the case at present. This is necessary, as the efficiency of the Public Accounts Committee can only be derived from its consciousness that it is supported in its inquiry into the public accounts by the legislature and by public opinion.

Lastly, the composition and functions of the Public Accounts Committee should be liberalized and brought more into line with the composition and functions of the English Committee. The Chairman should be a non-official as in Great Britain. At present the Finance Member of the Governor-General's Executive Council is *ex officio* Chairman. Even in official circles, it is felt that the dual position of the Finance Member, as a member of the Executive Government, and as the Chairman of a Committee criticizing the proceedings of the Government, is far from satisfactory. The Committee should also be empowered, as in Great Britain, to review all financial transactions, whether they relate to revenue or expendi-

ture, stores or property. This naturally cannot be done until the scope of the Auditor-General's functions is enlarged, as suggested in this chapter. For, until all financial transactions are scrutinized on its behalf by an expert, the Committee will have nothing before it to bring under review.

SECTION II
COMMERCE

Chapter I

THE DEMAND FOR SAFEGUARDS

THE transfer of commerce, like the transfer of finance, raises some controversial issues. There is no dispute regarding the transfer of the subject itself. The only question is whether any guarantees, and if so what, are reasonably called for in making the transfer. Everybody is agreed that commerce and industry must be a transferred subject, and that the control of economic policy must be vested in the federal legislature. Owing, however, to the position which British traders have occupied under the present system of government, and the unfortunate incidents of certain past transactions such as the cotton excise, there is a genuine fear of retaliation and expropriation in the minds of Englishmen doing business in India. They apprehend that they may be treated as aliens in a self-governing India, and not as citizens on a footing of equality with Indians. The demand, therefore, is that before the British Government transfers power over commerce to the Indian people it should satisfy the British community that:

(i) adequate safeguards are provided in the Constitution Act against unfair discrimination in commercial matters, in legislation and administration; and

(ii) proper machinery is created at the same time to make the above safeguards effective in practice.

The apprehensions of the British community do not appear altogether unjustified when we see that Indians are asking for similar safeguards in a separated Burma. They also see what is happening in other countries of the world under the guise of economic nationalism, which has been asserting itself rather blatantly of late. Each country wants to make itself economically self-sufficing and the

revival of the old policy of pushing exports and discouraging imports with a view to securing a favourable balance of trade has succeeded in strangling international trade and inflicted serious injury on every country in the world. In Southern Ireland (which exercises an uncanny influence on the course of Indian politics) British and other non-Irish firms wishing to establish a factory have to obtain a licence from the Minister for Industry and Commerce, who is given a complete discretion in the matter. The Irish Government has declared that 'such licences would be granted very sparingly and only in cases in which native interests would not be affected'. In China also discrimination against foreign imports and foreign capital is being deliberately enforced, and in matters of provincial and municipal taxation, freights on railways, and grant of special privileges, indigenous enterprise receives distinct preferences which are denied to foreign capitalists and foreign businesses.

In fairness to the British community, it is necessary to point out that there is a section which does not place much reliance on constitutional safeguards. In their view, such safeguards will prove illusory unless the agreement of Indian commercial opinion is secured. They lay stress on getting British and Indian business men to meet together and hammer out a settlement rather than placing the matter in the hands of politicians who, they think, will fail in a time of real difficulty. They also think that such a settlement would detach the Indian commercial community from the extreme school of political thought and thus dry up the springs of political agitation in India.

The question of commercial discrimination divides itself into two categories:

(i) as affecting persons ordinarily resident or carrying on trade or business in India; and

(ii) as affecting persons and bodies in the United Kingdom trading with India, but neither resident nor possessing establishments there.

The issues arising under each category are not always similar in character nor are they susceptible of similarity in treatment and will therefore be discussed separately.

Chapter II

INDIVIDUALS AND FIRMS CARRYING ON BUSINESS IN INDIA

THE claim of European commerce to fair treatment is generally accepted. It was conceded in the Nehru Report in the following terms:

'As regards European commerce we cannot see why men who have put great sums[1] of money into India should at all be nervous. It is inconceivable that there can be any discriminating legislation against any community doing business lawfully in India.'

Indian opinion of all shades of thought is unanimous that there should be no discrimination merely on the grounds of race, colour, or creed. But there is a strong body of commercial opinion in India which is not prepared to agree with the Federal Structure Committee in putting this principle in the form that 'equal rights and equal opportunities should be afforded to all persons lawfully engaged in commerce and industry within the territory of the Federation'.

The Committee have recommended that

'no subject of the Crown who may be ordinarily resident or carrying on trade or business in British India should be subjected to any disability or discrimination, legislative or administrative, by reason of his race, descent, religion, or place of birth, in respect of taxation, the holding of property, the carrying on of any profession, trade, or business, or in respect of residence or travel. The expression "subject" must here be understood as including firms, companies, or corporations carrying on business within the area of the Federation, as well as private individuals'.

[1] It is stated that the total amount of British capital invested in India comes to about £1,000 millions.

Key Industries.

There are, however, some obvious limitations to the application of the above principle in practice. The first limitation arises in the case of key industries. It is the right of every people to protect national industries and national enterprises from being killed or weakened by undue competition from non-nationals. With this desire of India to protect her key industries, British opinion is also in agreement. The Prime Minister of Great Britain admitted this in the following words:

'If there is national policy with regard to, say, key industries, supposing India wishes to manufacture optical glass which has been declared as a key industry in some countries for one reason or another, then India would be entitled to pass the same sort of economic legislation, as, say, this country would be entitled to pass.'

In the case of the contract relating to the Air Mail Service, the Government of India agreed that it was necessary that before a company could be given such a contract it should satisfy Government that a certain proportion of its directors and shareholders were Indian.

A list of industries, so classed, might be prepared and incorporated in a statutory schedule. Such a list would necessarily be subject to revision from time to time and would not prevent the Executive Government from taking such action as it might deem necessary in a national emergency. The existence of such a list, however, would prevent critics saying that the Federal Government, by an easy manipulation of the term 'Key Industries', might enforce the Indianization of virtually every European enterprise in India. It is already being said that the Indian National Congress has classified the manufacture of cotton goods as a key industry, and there is no rule, theoretical or

practical, to prevent every commercial concern in India under European control being included in the same category.

Nationalization of Industries.

The above principle of 'no discrimination' should also be subject to the right of the National Government to acquire public utility undertakings, such as railway, tramway, and electric supply companies, &c., in the national interest. While the national government would not be debarred from treating any industry (present or future) as a fit subject for nationalization, it is only fair that wherever rights under existing leases or licences are acquired or otherwise interfered with, adequate compensation as determined by a judicial tribunal should be paid. This principle is recognized even now in the case of acquisition of land for public purposes. It is only just and proper, as is pointed out in the report of the Federal Structure Committee, that property rights should be guaranteed in the Constitution and that provision should be made whereby no person can be deprived of his property, save by due process of law and for public purposes, and then only on payment of fair and just compensation to be assessed by a judicial tribunal.[1] This is recognized in the Constitution framed by the Nehru Committee as a fundamental right and is provided for as follows:

'No person shall be deprived of his property, nor shall his dwelling or property be entered, sequestered, or confiscated, save in accordance with law. All titles to private and personal property lawfully acquired and enjoyed at the establishment of the Commonwealth (of India) are hereby guaranteed.'

Such a clause is to be found in most existing Constitutions.

[1] Such a guarantee is demanded not only by the British commercial community but also by Indian landlords.

Article 11 of the Irish Free State Act provides as follows:

'All the lands and waters, mines and minerals, within the territory of the Irish Free State hitherto vested in the State, or any department thereof, or held for the public use or benefit, and also all the natural resources of the same territory (including the air and all forms of potential energy), and also all royalties and franchises within that territory shall, from and after the date of the coming into operation of this Constitution, belong to the Irish Free State, subject to any trusts, grants, leases, or concessions then existing in respect thereof, or any valid private interest therein, and shall be controlled and administered by the Oireachtas [legislature], in accordance with such regulations and provisions as shall be from time to time approved by legislation, but the same shall not, nor shall any part thereof, be alienated, but may in the public interest be from time to time granted by way of lease or license to be worked or enjoyed under the authority and subject to the control of the Oireachtas, provided that no such lease or licence may be made for a term exceeding ninety-nine years, beginning from the date thereof, and no such lease or licence may be renewable by the terms thereof.'

Article 153 of the German Constitution provides as follows:

'Property is guaranteed by the Constitution. Its extent and the restrictions placed upon it are defined by law.

'Expropriation may be effected only for the benefit of the general community and upon the basis of law. It shall be accompanied by due compensation, save in so far as may be otherwise provided by a law of the Reich. In case of dispute as to the amount of compensation, resort may be had to legal proceedings in the ordinary course, unless a law of the Reich otherwise determines. Property of the States, local authorities, and public utility associations may be expropriated by the Reich only on payment of compensation.

'The ownership of property entails obligations. Its use must at the same time serve the common good.'

Similar provision is to be found in the Danish Constitution, Article 80 of which reads as under:

'Property is inviolable. No person may be deprived of his property, save where the public good requires it. Expropriation can only take place in consequence of legislation and on payment of full indemnity.'

The Federal Structure Committee have recommended as 'specially worthy of consideration' the following provision on the subject in Article 99 of the Polish Constitution:

'The Polish Republic guarantees the right of property, whether the individual property of citizens or the corporate property of associations of citizens, autonomous bodies, or the State itself, as one of the fundamental principles of society, and of law and order; the Republic guarantees to all its inhabitants, institutions, and communities, the protection of their property, and allows limitations or abolition of individual or collective property only in cases provided for by law for reasons of general utility and with compensation. The law alone can decide what kinds of property, and within what limits, may be in the exclusive ownership of the State, upon grounds of public utility, and also what limitations may be imposed upon the rights of citizens and of corporations recognized by law to exploit the land, waters, minerals, and other natural resources. Land, being one of the principal factors of the life of the nation and of the State, must not be the object of unlimited alienation. The laws shall prescribe the degree in which the State has the right of compulsory purchase of rural property, and of controlling the transfer of such property in conformity with the principle that the agrarian structure of the Polish Republic ought to be based on agricultural holdings capable of normal productivity and privately owned.'

Mahatma Gandhi, on behalf of the Indian National Congress, submitted the following formula:

'No existing interest legitimately acquired, and not being in conflict with the best interests of the nation in general, shall be interfered with, except in accordance with the law applicable to such interests.'

It will be observed that according to the above point of view a title to property before it could be recognized must fulfil two conditions. First, it must have been 'legitimately acquired' and secondly, it must not be 'in conflict with the best interests of the nation in general'.

Mahatma Gandhi explained what he meant by the above conditions. He laid stress on the fact that the formula was not intended to be applied only to Europeans. It would be applied as ruthlessly and impartially to Indians as to Europeans. By the phrase 'legitimately acquired', it was meant that 'every interest must have been taintless, it must be above suspicion, like Caesar's wife'. He pointed out that he had in mind cases of Indians who were in possession of land which had been practically given away to them, not for any service rendered to the nation or even to the Government, but for some service rendered to a Government official. These would equally come up for examination by the National Government along with certain monopolies and privileges enjoyed by Europeans under the present Government. If this can be called discrimination, it would be discrimination in the national interest, irrespective of race, colour, or religion.

The second condition, viz., 'not being in conflict with the best interests of the nation', was explained by Mahatma Gandhi as follows:

'I have in mind certain monopolies, legitimately acquired, undoubtedly, but which have been brought into being in conflict with the best interests of the nation. Let me give you an

illustration which will amuse you somewhat, but which is on neutral ground. Take this white elephant which is called New Delhi. Crores have been spent upon it. Suppose that the future Government comes to the conclusion that this white elephant, seeing that we have got it, ought to be turned to some use. Imagine that in old Delhi there is plague or cholera going on, and we want hospitals for the poor people. What are we to do? Do you suppose the National Government will build hospitals and so on? Nothing of the kind. We will take charge of those buildings and put these plague-stricken people in them and use them as hospitals, because I contend that those buildings are in conflict with the best interests of the nation.

If the National Government comes to the conclusion that that place is unnecessary, no matter what interests are concerned (whether they be Ruling Princes, Europeans, or Indians), they will be dispossessed, and they will be dispossessed, I may tell you, without any compensation, because if you want this Government to pay compensation, it will have to rob Peter to pay Paul, and that would be impossible.'

Mahatma Gandhi subsequently made it clear that this formula did not cover private property generally throughout the country; it was mainly directed towards property which had been Crown property and which had passed into the hands of some private person or persons.

A similar economic gospel is being preached in Southern Ireland, but with this important difference that Mr. De Valera's Government, in taking from the haves and giving to the have-nots, has declared its intention of paying compensation and dealing with vested interests in a 'proper' manner.

Unfair Competition.

It is not an easy matter to define unfair competition in trade and business. There are no recognized criteria or rules that can be applied, as in a game of cards or chess. New methods are constantly being evolved and competi-

tion is growing keener every day in the desire to consolidate one's position in existing markets and search for new ones. There is, however, general agreement that legislation might be passed on the lines of that adopted in practically every country empowering the Executive to safeguard an industry from abnormal imports, savage price-cutting, or dumping as it is popularly called, unfair rebates, and depreciated currency, or on the lines of the Commercial Trust Act in New Zealand, or the Sherman and Clayton Acts in America in the case of monopolies exercising an unhealthy influence on business and trade. As an instance in point might be cited the case of the Indian match industry, whose existence is seriously threatened by unfair competition from the Swedish Syndicate which practically enjoys a monopoly in the industry. There is such a terrific rate war in progress between the Swedish Company and the Indian Companies that the latter have been obliged to reduce output and some have even closed their factories. Others, it is said, will soon be driven to selling their factories to the Swedish Company at any price it may choose to offer. Another instance is that of the Indian iron and steel industry which is meeting with unfair competition from European countries, who in order to maintain their production are dumping their produce on the Indian market at prices which are far below their cost of production. The Indian cotton industry is also threatened with severe competition from Japan, owing to an artificial advantage created by depreciation of the Japanese currency.

There will be no disposition to disagree regarding the desirability of State intervention in cases of the type mentioned above. But British commercial opinion insists that whatever action is taken on allegations of unfair competition in trade and business, must be taken against types of

business activity regarded as improper, irrespective of whether they emanate from Indian or non-Indian firms, e.g. unfair rebates or savage price-cutting, as such, *in all businesses and not against such activities in particular businesses only*. This point was explained by Lord Reading in the following terms:

'You cannot have a law directed against one particular concern; you must have the general law of the land applicable to them. If it is unfair competition, then it is unfair competition not only in that trade, but in every other trade, *and if it is unfair competition and you want to legislate against it, then you must legislate against it for all trades.*'

Care will, however, be necessary to see that in checking unfair competition, ordinary competitive methods of carrying on business are not banned.

'In many industries and businesses big British firms have acquired a dominating position for economic and historical reasons. Big firms do not always encourage new competitors and the steps they take to crush their struggling rivals sometimes appear harsh. Where the struggle is between a large British and a small British firm, no one thinks of legislative interference, nor does any one cry out if a large Indian firm strangles a small Indian competitor. But in the circumstances of India the struggle is often between a big British and a small Indian business, so that the affair is easily represented as a racial struggle, and an Indian legislature may easily be tempted to retaliate by attacking the big firm for action which was, in fact, perfectly legitimate.' (*Manchester Guardian.*)

Subsidies or Bounties to Industries.

It is clear that when the legislature grants a bounty or subsidy for the purpose of encouraging a local industry, it must have the right to attach reasonable conditions to any such grant from public funds. The question is obviously one for the legislature to decide on the merits of

each case, but here again there is a considerable difference of opinion. Indian public men feel strongly that only Indians should be entitled to receive financial concessions from public funds, and that such benefits should be withheld from non-nationals, even though they be Britons engaged in the industry in question in India. British opinion, however, is that any person engaged in the industry who is willing to fulfil the conditions that may be prescribed, should be eligible to the bounty or subsidy in question, irrespective of the fact that he is Indian or non-Indian. Some would be willing to exclude aliens from the benefits of such grants, but not Britons. It is pointed out that in England, for instance, where a subsidy is given to the sugar-beet industry, no discrimination is made between Britons and foreigners and all are alike eligible, so long as they fulfil the conditions prescribed.

In India also, the position at present is the same as in England. Subsidy is given, as in the case of steel, to a particular industry on certain conditions open to all and not on racial lines, to a particular firm or firms engaged in the industry in question, to the exclusion of others.

But what Indians have in mind would be something like the subsidy granted by Italy to Italian shipping lines plying between Europe and India. This subsidy has put British shipping companies operating in the same waters at a great disadvantage. It is quite conceivable that a similar subsidy may be granted by the new Indian Government to Indian shipping companies, from the benefits of which British and foreign companies may be excluded. In fact, as is well known, the whole controversy over racial discrimination in matters of trade and commerce arose over a bill proposing to reserve coastal shipping to Indian-owned vessels.

The question was considered in 1925 by the External

Capital Committee, who made the following recommendations on the subject:

'Where definite pecuniary assistance, such as a bounty, is granted to any particular undertaking, we consider that discrimination is feasible, and we agree with the Fiscal Commission and the legislature that no such assistance should be granted to any company, firm, or person not already engaged in that industry in India, unless,

(1) reasonable facilities are granted for the training of Indians, and

(2) in the case of a public company, unless,
  (a) it has been formed and registered under the Indian Companies Act 1913,
  (b) it has a share capital the amount of which is expressed in the memorandum of association in rupees,
  (c) such proportion of the directors as Government may prescribe consists of Indians.'

The above recommendations were sanctioned by the Government of India and are now in operation. It will be observed that what the External Capital Committee had in mind was cases 'where definite pecuniary assistance such as bounty' is granted. Their recommendations did not apply to cases where assistance is given in the form of tariff protection. But during the winter session of 1932, the Legislative Assembly in dealing with a proposal for tariff protection to the paper industry succeeded in imposing its view that the same conditions should apply to grants of tariff protection as to bounties and subsidies, as both were in effect a kind of financial assistance from the general public, though in a different form.

Great stress was laid in the debate on the training of Indian apprentices by European firms applying for tariff protection. It has always been a grievance of Indians against British firms doing business in India that they do not employ Indians in the superior ranks. The paper

manufacturers agreed to this demand, and we may take it that the policy of Indianization in industry will come increasingly to the front as time goes on. It is not at all unlikely that in the near future the same conditions would be made applicable to firms to whom Government contracts are given, which in India are not altogether inconsiderable. British opinion agrees that conditions like those recommended by the External Capital Committee may be imposed in cases where financial assistance is given. Indian opinion is opposed to any restriction being imposed upon the discretion of the federal legislature to attach any conditions it might think fit. It is felt that in the case of infant industries some protection in the nature of bounties or subsidies against foreign (including British) industries which have secured a firm footing in the country is necessary in the interests of India.

The Indian view is that if non-Indian firms are declared eligible, the object of giving the grant, which is protection against non-Indian firms, would be defeated and the same non-Indian firms would be encouraged to go out to India and place themselves in a position of equality with the Indian industry with a view to driving the latter out of existence, as has actually happened in the case of the match industry, and might happen in the case of the cotton textile industry.

In reply, it is said that even if the above contingency were to materialize India would be the gainer and not a loser. India would gain by the employment which her people would get, her Government would gain by the taxes the industry would pay, and the country generally would gain by the increased supply of technical knowledge. The Fiscal Commission held that 'though the foreign capitalist may get his profit, the main advantage from the employment of foreign capital remains with the country

in which it is employed. In the case of India this is particularly clear' (paragraph 289).

The English people are particularly afraid that if it is agreed that British firms will be ineligible, bounties would be granted to Indian firms, chiefly to enable them to wipe out of existence their British competitors. This would, in their view, be tantamount to unfair discrimination.

Pandit Madan Mohan Malaviya, during the course of the debate in the Federal Structure Committee last year, made the following observations:

'Protection of the rights of persons trading in India is one thing; the development by all legitimate means of the indigenous industries of the country is quite another matter. Foreigners and British subjects trading in India are entitled to ask for the protection of their commercial rights; they are not entitled to ask for that measure of assistance and protection which Indian indigenous industries in India are entitled to ask for.'

In other words, while India is willing that there shall be no discrimination against non-nationals as such, it insists on the right to exercise discrimination in favour of its own nationals.

No argument can be based on the analogy of English practice in this matter. England is a highly industrialized country and there is not much chance of outsiders supplanting English manufacturers and capitalists on English soil in a manner that would become a serious menace to British interests. But such a danger is not so unreal in the case of India in its present infantile stage of industrial development.

If it is right to protect infant industries in India by imposing protective tariffs against competing non-Indian firms established outside its border, surely it cannot be wrong to give the same help in the form of bounties or

subsidies if it be found that non-Indian firms have established themselves in India to escape the payment of protective customs duties.

Subsidies and bounties are given in India only on the recommendation of the Tariff Board, which is an impartial and non-political body, whose duty it is to give a fair hearing to the pros and cons of each application submitted for its consideration. The consideration of each case by the Tariff Board on its merits should be a sufficient guarantee that subsidies or bounties will not be granted to Indian firms merely to kill British enterprises legitimately established in the country, as is apprehended in certain quarters.

Method of giving effect to the Principle.

We have been hitherto discussing the limitations to which the principle of 'no discrimination' should be subject, in so far as persons normally resident or carrying on trade or business in India are concerned. We have seen that before the principle can be given general application, reservations should be made to provide for:

(i) the special treatment of key industries;
(ii) the right of nationalization of industries;
(iii) regulation of unfair competition;
(iv) State help to industries, whether in the form of bounties, subsidies, or tariff protection.

Subject to the above reservations, there seems no objection to the acceptance of the principle, as recommended by the Federal Structure Committee.

The next question is, how best to give effect to the principle as modified above.

The Nehru Report attempts to provide for it by defining in the Constitution those persons who are to be regarded as 'citizens' and then applying the principle to all 'citizens'

as so defined. The definition of the term 'citizen' in the Nehru Constitution is as follows:

'The word "citizen" wherever it occurs in this Constitution means every person

(*a*) who was born, or whose father was either born or naturalized, within the territorial limits of the Commonwealth and has not been naturalized as a citizen of any other country;

(*b*) who being a subject of an Indian State ordinarily carries on business or resides in the territories of the Commonwealth;

(*c*) or, who, being a subject of the Crown carries on business or resides in the territories of the Commonwealth;

(*d*) who is naturalized in the Commonwealth under the law in force for the time being.

Explanation: No person who is a citizen of a foreign country can be a citizen of the Commonwealth unless he renounces the citizenship of such foreign country in the manner prescribed by law.'

Clause (*c*) of the above definition would apply to the case of Britons carrying on trade or business in India, but the term 'citizen' as defined above could hardly include a corporation or limited company, though it is contended that there could be no bar to such an inclusion in the eyes of the law.

The Federal Structure Committee have suggested that the Constitution should contain a clause prohibiting legislative or administrative discrimination in respect of taxation, the holding of property, the carrying on of any profession, trade, or business, or in respect of residence or travel, and defining those persons and bodies to whom the clause is to apply.

The Indian Statutory Commission, while dealing with a similar suggestion made to them, reported that such a

clause would be found difficult to draft and would prove ineffective in practice. To quote their own words:

'On our suggestion the two bodies (the European Association and the Associated Chambers of Commerce) submitted to us drafts of clauses which they would desire to be enacted to secure their objects. We have given careful consideration to their proposals, but there are objections to securing protection by the means they suggest to which we can find no answer. Many other interests have asked for similar constitutional safeguards and we are clear that statutory protection could not be limited to particular minorities, or to discrimination in matters of trade and commerce only. The statutory provision would, therefore, have to be drawn so widely as to be little more than a statement of abstract principle, affording no precise guidance to courts which would be asked to decide whether a particular group constituted a minority, and whether the action complained of was discriminatory. Moreover, having regard especially to the ingenuity and persistence with which such litigation is carried on in India, we should anticipate that an enactment of the kind would result in the transfer to the law courts of disputes which cannot be conveniently disposed of by such means. It has always to be remembered that, if a law court has jurisdiction to dispose of well-founded claims based on solid grounds, it is also bound to listen to far-fetched complaints with no real substance behind them. *These objections are decisive against the proposal to prevent discriminatory legislation by attempting to define it in a constitutional instrument.*'

The fact that the Statutory Commission was presided over by a constitutional lawyer of eminence should give this finding great weight, but the Federal Structure Committee presided over by another constitutional lawyer of eminence, Lord Sankey, do not share this view.

'They see no reason to doubt that an experienced Parliamentary draftsman would be able to devise an adequate and workable formula, which it would not be beyond the competence of a Court of Law to interpret and make effective.'

We may take it that this is the view which holds the field and that effect would be given to it.

Once such a clause is incorporated in the Constitutional Act, discriminatory legislation would be a matter for review by the Federal Court. Protection against discriminatory Bills would also lie in the power of disallowance and reservation for the signification of His Majesty's pleasure which would be vested in the Governor-General and the Provincial Governors.

As regards discrimination in administration, there can be no safeguard beyond that provided by good faith and good sense inherent in civilized human beings. If mutual good will be lacking, what power can, for instance, prevent the rejection by competent administrative authority of lower non-Indian tenders for any particular contract in favour of a higher tender of an Indian firm? In cases of major importance, resort may be had to the special administrative powers for the protection of minorities which, it is proposed, should be vested in the Governor-General and the Provincial Governors.

Chapter III

BRITISH TRADE WITH INDIA

PREVENTION of discrimination against British trade with India is as important a British interest, if not more, as the protection of the interests of the British community doing business in India. This question was dealt with at some length by the Round Table Conference, and recently the holding of the Imperial Economic Conference at Ottawa has focussed public attention on the subject in both the countries.

We are concerned here only with such matters affecting British trade as must be taken into account in framing a new Constitution for India, and as it is generally the tariff and the way it is apprehended that it will be used, we must first deal with the transfer of power in regard to the customs tariff.

The Customs Tariff.

The present-day customs tariff of India is largely a revenue tariff and is an important factor in Indian finance. Only 5 per cent. of the customs revenue is derived from protective duties, the remaining 95 per cent. has been imposed solely for revenue purposes. In the eight years since the establishment of the Tariff Board, only five industries have received protection, namely,

1. The steel industry.
2. The bamboo paper industry.
3. The match industry.
4. The cotton textile industry.
5. The sugar industry.

It is a matter of profound satisfaction that throughout the discussion of the subject at the Round Table Con-

ference, no suggestion of any restriction on the transfer of power with regard to tariffs was made by the representatives of British commerce. On the other hand, it was fully accepted that India should have full freedom to regulate her tariff policy. Sir Hubert Carr, on behalf of the British commercial community, made this point quite clear in his speech at the Conference on 16th January 1931:

'We accept all Indian aspirations with regard to tariffs; we have nothing to say against them; but if within that tariff wall we are working, we do demand exactly the same rights as Indian-born subjects.'

When India is free to use tariffs as she likes, she will naturally consider her own interests first, in the same sense as is done by Canada and Australia, but there is no reason to apprehend any hostility to British trading interests or even to fear that the moment she secures full control over fiscal policy she will raise an impossibly high tariff wall against Great Britain.

Sir Purshottamdass Thakurdass, representing the Indian commercial community, rightly laid great stress on this point at the meeting of the Federal Structure Committee on 19th November 1931:

'There are funny apprehensions in connexion with the likelihood of India under a self-governing Government building up enormous tariff walls immediately against imports from abroad, including perhaps imports from Great Britain. I have been in the Central legislature for the last seven years, and unless I have grossly misinterpreted the inclinations of members from the rural and urban areas in the Central legislature, I am convinced that the reformed legislature of the type we contemplate in a self-governing India will be very chary about passing any legislation regarding import tariffs, and that they will bring up with greater emphasis than has been done till now the question of the interest of the consumer. I myself feel,

and I have said it before now, that the opposition that has been forthcoming till now in the Central legislature regarding any protective measure is likely to increase at least ten times if people were assured that there was no control being exercised from outside India and that the Government of India were free to take decisions on the merits of a case as it affects India alone.'

Professor Coatman, of the London School of Economics, made the same point in a discussion on Indian finance at the East India Association on 24th May 1932. He said that

'the whole future of Indian fiscal policy was very doubtful, because already in the Assembly a very strong divergence of opinion between Protectionist Provinces and Free Trade Provinces of India had developed and that once India got an autonomous Government one of the first real divisions between political parties would be on the question of Free Trade and Protection'.

Moreover, India depends upon foreign countries to buy her products, and if she gave them cause for provocation by an unjust use of the tariff she would be subjecting herself to retaliation from them and would have to weigh carefully the pros and cons of each measure before giving effect to it. She will also be in a position to use the tariff as a means of promoting her own trade by suitable commercial conventions and trade agreements. As has been stated by Mr. Baldwin, there is no surer or quicker instrument in commercial bargaining between nations than the customs tariff.

It is sometimes said that the manufacturing class is the vocal class, whereas the vast mass of consumers belong to the rural classes who are politically inarticulate. This may or may not be true. But the very statement of the case suggests a remedy.

It is in every way necessary that the Federal legislature should be genuinely representative of all interests in the country and consequently the surest means of providing economic justice and security would be the adequate representation of the consumer and the agriculturist along with the industrialist and the manufacturer. Beyond this, no restriction or reservation of any kind is called for. A policy of trust would be the best, in the British as well as the Indian interest.

It is a matter of very genuine gratification to the present writer to find that since the above view was expressed in writing, the *Manchester Guardian* in its issue of 5th May 1932 has said exactly the same thing:

> 'It is becoming increasingly clear that no statutory safeguards are likely to be effective in protecting [European] firms against a certain amount of legislative and administrative discrimination. The best safeguard will be a Legislature based on electorates in which the rural interests have their proper weight, for the driving force at present comes from the urban middle classes.'

Tariff Preference on Basis of Reciprocity.

The question of tariff preference between Great Britain and India is not relevant to the constitutional problem, with which alone we are concerned here, but as it was discussed at some length at the meetings of the Second Round Table Conference, a brief reference to it is made in the following paragraphs.

Since the days of Lord Curzon, public opinion in India has been unfavourable to the doctrine of Imperial Preference. The Indian Fiscal Commission examined the question in some detail and reported that India had nothing to gain by the adoption of the principle of Imperial Preference. The Indian Government has always

instructed its representatives at Imperial Conferences in this sense, and in framing its views on the question it is bound to give full weight to the views of the Legislature, whose support would be necessary for any alteration in fiscal policy. G27032 | 51828

Great stress was laid at both the sessions of the Round Table Conference on the conclusion of a trade agreement between Great Britain and India based on reciprocity and providing for most-favoured-nation treatment between the two countries. Insistence was laid on an agreement, because it would be based on the consent of India and would therefore be regarded as binding in a greater degree than a mere provision in a Constitution Act which being unilateral would be regarded in the nature of an imposition on India. Some persons went further and suggested a tripartite trade agreement between Great Britain, India, and Burma on similar lines. It was considered that India might agree to give trade concessions to Great Britain if she got similar concessions for her own trade in Burma where she was afraid of discrimination against herself.

A trade agreement to which Indians are a party would, of course, be honoured, but such an agreement could only be made after the transfer of power under the new constitution. If such an agreement were made by the present Government of India, even with the approval of the present legislature, it would not be binding on the new Government and the new legislature. Its existence might even be the source of unnecessary irritation and friction between the two countries. On the other hand, there is in certain quarters a real apprehension that the new Indian legislature might refuse to ratify and thus British trade would be left absolutely unprotected—a contingency which they are not prepared to face. 336·54

The Federal Structure Committee held that a trade

agreement would be more appropriately made between the United Kingdom and the future Indian Government when the latter was constituted and that in any event it could scarcely find a place in a Constitution Act. The latter remark was with reference to a suggestion made by the representative of the British trading community that the trade agreement should form a schedule to the Constitution Act.

Mr. Gandhi's views on the subject are well known. He gave repeated expression to them during his visit to England. To quote his own words:

'If there was no competition, and if it became clear that some foreign cloth had to come to India, and if England was in partnership with India freed, I would give preference to England over all other countries.'

The above views were expressed before the new policy of tariff protection was adopted by His Majesty's Government in England and are strictly applicable only to the wholesale adoption of preference in relation to all imports from Great Britain and not to a few selected articles on a basis of reciprocity. Nobody now asks India to adopt a general policy of Imperial Preference, but only to consider the question of tariff preference as a matter of business and not of sentiment. There is no reason why India should refuse to develop her export trade if she finds she can do so by adopting a policy of give and take in relation to Empire countries.

As long as England was a free-trade country she could offer no advantage to India in return for a lower tariff on imports of British goods into India. But now India has to weigh the advantage of a preference by Great Britain to her against a preference by her to Great Britain. Moreover, India no longer retains the former position of a monopolist in regard to her exports to Great Britain.

Several competitive suppliers, within the Empire and without it, have sprung up.

There can be no objection in principle to tariff preference on a basis of reciprocity with Empire countries, as there was to the old doctrine of general Imperial Preference. It is all a question of details; a balancing of advantages obtained against advantages granted and their effect on the total foreign trade of the country. It is in this light that the new trade agreement entered into at Ottawa between Great Britain and India will naturally be considered. We do not propose to make a detailed study of this document here, but it is relevant to our point to note that the agreement in no way ties the hands of the responsible government of a Federal India. Even if approved by the present Indian legislature, it may be denounced by either party (Great Britain or India) on giving six months' notice. In this manner it satisfies the Indian demand that

'it should be left to the future popular Government of the country, which will be constituted by the new Government of India Act, to shape its policy regarding inter-imperial trade relations, including the application of any reciprocal preferential tariff agreement in a manner as will best serve the interests of this country'. (Extract from letter from the President of the Federation of Indian Chambers of Commerce to the Government on the subject of India's participation in the Ottawa Conference.)

The preservation unimpaired of the protection enjoyed by certain Indian industries at present will also be regarded with approval in India.

Chapter IV

COMMERCIAL TREATIES

BEFORE any question of trade agreement with Great Britain can be considered, it is obvious that India must have the power to conclude commercial treaties with other countries, as may be considered best in Indian interests. As long as the power to conclude commercial treaties on behalf of India vests in the British Government, no trade agreement between India and Great Britain or with other countries can have any meaning or value.

We are, therefore, led to consider the general question of commercial treaties which was also discussed at the Round Table Conference in connexion with External Affairs, of which larger subject it really forms a part. When that discussion took place, a claim was made on behalf of the Indian National Congress that India should be put in regard to such matters in the same position as the Dominions. To understand this claim, it is necessary to realize what the position of the Dominions is with regard to commercial treaties. For several years the Dominions have enjoyed considerable freedom in the matter of commercial treaties which they have been negotiating through their own representatives in foreign countries. There was, however, some doubt as to the channel of communication between the Dominion and Foreign Governments, which was finally set at rest by the following recommendation of the Imperial Conference of 1930:

'As regards subjects not falling within the category of matters of general and political concern, the Conference felt that it would be to the general advantage if communications passed direct between His Majesty's Governments in the Dominions and the Ambassador or Minister concerned. It was thought

that it would be of practical convenience to define, as far as possible, the matters falling within this arrangement; *the definition would include such matters as, for example, the negotiation of commercial arrangements affecting exclusively a Dominion Government and a foreign Power*, complimentary messages, invitations to non-political conferences, and requests for information of a technical or scientific character. If it appeared hereafter that the definitions were not sufficiently exhaustive it could of course be added to at any time.' (Pages 29–30 of the Summary of the Proceedings of the Imperial Conference, 1930.)

It is now clearly recognized that the Dominions are free to enter into direct negotiations with foreign Powers and conclude with them such agreements as they think best, independently of His Majesty's Government in the United Kingdom.

The position in regard to these matters in India is very different. Under section 44 of the Government of India Act all treaties (political or commercial) require the sanction of the Secretary of State for India. The Government of India, if it desired to conclude a commercial treaty to suit India's special requirements, would have first to submit its case to the Secretary of State for India, who, if he agreed, would have to secure the concurrence of the British Foreign Office before any steps could be taken to address the foreign government with whom the treaty was proposed to be concluded.

There are certain commercial conventions with France, Japan, Greece, and Poland which have been concluded by the British Foreign Office on behalf of the Government of India.

It is the practice of His Majesty's Government in Great Britain not to include India within the scope of any commercial treaty which they may decide to conclude with any foreign country, without the express consent of the

Government of India acting on behalf of India. Such treaties usually provide that, although the stipulations contained in them do not automatically apply to India, Indian goods shall receive most-favoured-nation treatment so long as similar treatment is accorded by India to the goods of the other contracting party.

Whenever any negotiations regarding commercial treaties are going on between Great Britain and a foreign country, the Government of India is consulted by His Majesty's Government on any points affecting India, and when the negotiations are complete, the Government of India is asked by the British Foreign Office to state definitely whether they desire to adhere to the agreement.

It will, thus, appear that under the present Constitution the Government of India is consulted and has the option to refuse to adhere to a commercial treaty concluded by Great Britain, but has no power of concluding any commercial arrangement with Empire or foreign countries without reference to His Majesty's Government.

The question came up for examination by the Indian Statutory Commission, as will appear from the following questions put to Sir Geoffrey Corbett, then Secretary, Commerce Department, Government of India, in his examination by the Commission at Delhi dated 24th November 1928:

'109. Lord Strathcona: One question about commercial treaties. It appears that India has not the power to enter into direct negotiations with foreign countries in the same way that I think the Dominions can and that India has separate conventions with foreign powers which are negotiated through the Foreign Office?—Yes, that is correct.

'110. Do you consider the fact that these conventions are negotiated through the Foreign Office on behalf of the Government of India is in any way detrimental to the interests of

India?—Very much to her benefit. We have the experienced advice and assistance of the Foreign Office and His Majesty's Ambassadors to negotiate our affairs for us in a way that we can never hope to do.

'111. And it causes no delay?—They are extremely prompt.' (Page 167 of the Commission Evidence, volume xv.)

Sir Geoffrey Corbett gave it as his view that the present arrangement has resulted in great benefit to India. This may be true generally, but so far as the commercial treaty with Japan is concerned, public opinion, both British and Indian, is unanimous that the treaty is injurious to Indian commercial interests. Owing to an omission in this treaty of the usual and necessary clauses regarding prohibition and restrictions on importation, exportation, and transit, Japan has found it possible to prohibit the import of Indian rice, while Siam is able to export rice to Japan without any restriction. At the annual general meeting of the Associated Chambers of Commerce in 1925, the following resolution was passed:

'That this Association recommends to the Government of India that the Convention with Japan of 5th March 1905 be terminated as soon as possible.'

At another meeting of the same body in 1928, Mr. W. T. Howison, representing Burma, made the following remarks:

'Now it happens that the only countries exporting rice to the Japanese Empire which have not made special provision in a treaty of commerce and navigation are India and French Indo-China.'

(N.B. The special provision to which Mr. Howison referred was about the restriction and prohibition of imports, exports, and transit mentioned above.)

Quite recently, Bombay and Bengal have been hit hard by Japanese commercial policy—the former in respect of

dumping of cotton goods facilitated by the depreciation of the yen, and the latter in respect of the 400 per cent. increase of duty on pig iron—and are both asking for the abrogation of the convention.

Another defect under the existing constitutional position is that all the interests affected are not properly consulted before a commercial treaty is concluded and, in some cases, even the text of the final document is not made available in time. For instance, a commercial treaty was concluded between Poland and India on 6th May 1931, but the text of the treaty was not published in India even till the end of December, though in Poland it was published as soon as it was made.

Apart from the above drawbacks of the present situation, it will be obvious that the responsible Minister for Commerce should be in a position to promote the interests of Indian commerce abroad and for this purpose he must be in a position to advance trade agreements with countries within the Empire and outside. The channel of communication is not so important as the text of the document, and so long as the substance of a commercial treaty is regarded as being within the purview of the responsible Minister for Commerce, the form in which it is concluded and its actual negotiation and conclusion might remain with the Minister in charge of External Affairs, who would be responsible to the Governor-General. All commercial treaties should be subject to ratification by the legislature.

With the adoption by His Majesty's Government of a general import tariff as a part of their fiscal policy, their angle of vision with regard to trade treaties must be different from what it was in the old Free Trade days. As was pointed out by Mr. Wedgwood Benn, control by the British Government in present circumstances would lay them under the suspicion of making commercial agree-

ments for India in such a way as to favour their own tariff policy, rather than with sole regard to Indian interests. It has, therefore, become all the more necessary that the substance of power in the matter of commercial treaties should be transferred to India simultaneously with the transfer of commerce.

SECTION III

FEDERAL FINANCE

Chapter I

GENERAL

THE moment it became clear that the political future of a self-governing India lay along the lines of a federation between British India and the Indian States, peoples' thoughts began to turn to finance and the importance of apportionment of resources and obligations, actual and potential, between the various partners in the Federation, so that each may be placed in a position to discharge smoothly and efficiently the functions appertaining to it under, or guaranteed by, the Constitution.

It became increasingly obvious that if federation was to lead the people of India to progress and prosperity, the financial arrangements should be such as to ensure that:

(i) the Central Government possessed sufficient resources to enable it to bear the major risks of Indian finance, such as Defence and the Credit of India, and sufficient power to collect additional funds to meet emergencies from whatever cause arising: political, due to external or internal trouble; or economic, caused by a breakdown of exchange and currency policy, or a run on postal savings banks, &c.

(ii) the provincial Governments had adequate resources of a growing character (which they have not at present) to enable them to meet the steadily increasing demands of the nation-building departments—such as education, medical, agriculture, and industries.

(iii) neither the Provinces nor the Centre be placed under the necessity of relying on 'doles' (or 'con-

tributions', as they are technically called) from one to the other, to balance their budgets.

(iv) the Provinces as well as the Centre should have separate heads of revenue and expenditure and in other respects also—such as taxation, borrowing, keeping of cash balances, accounts, and audit, &c. —a clear line of demarcation, as far as possible.

(v) each unit of the federation—the Provinces and the Indian States—should contribute towards common burdens on an equal basis.

As it was not possible for the Round Table Conference or its Committees to deal satisfactorily with all these matters, some of which required examination on the spot in India, they were remitted to two Committees for investigation and report. Items (i) to (iv) related to British India and were entrusted to the Percy Committee. This Committee contained representatives of the Indian States Delegation to the Round Table Conference, but no representative of the British-Indian Delegation. Item (v) related mostly to the Indian States and was entrusted to the Davidson Committee, which did not contain (perhaps on the same principle as the Percy Committee) a single representative of the Indian States Delegation.

The reports of both these Committees are now available and it is very gratifying to note that they have come to the conclusion that so far as financial arrangements of the federation are concerned, there need not be any doubt or misgiving. To quote their own words:

(i) 'Given a recovery from the present abnormal economic conditions, the financial scheme outlined in the Peel Report provides a foundation on which an Indian federation can be established and can begin its work.' (Paragraph 90, Percy Committee Report.)

(ii) 'It is in some form or other of federation that a remedy

for the economic grievances of the States in particular will most satisfactorily and effectively be found.' (Paragraph 437, Davidson Committee Report.)

'Our Report, which represents an honest endeavour to do justice between the parties [British India and the States] and to establish a fair and equitable basis which both of them can accept without prejudicing either their interests or their self-respect.' (Paragraph 449, Davidson Committee Report.)

As the *Manchester Guardian*, in its leading article of 28th July 1932, put it tersely,

'the adjustments proposed by the Davidson Report are both intelligent and considerate, and show that none of the Princes need be deterred from throwing in his lot with an All-India federation by economic considerations'.

All this is a great gain and will hearten those interested in the unity and steady progress of India. It is proposed in this section to treat these two reports as the basis of discussion and to offer such suggestions as seem necessary in the light of the information at our disposal.

Chapter II

ALLOCATION OF RESOURCES

UNDER the existing arrangement, the main heads of income of the Central Government are:

Customs.
Income-tax.
Salt.
Opium.
Railways.
Posts and Telegraphs.
Currency and Mint.

The main items of provincial revenue are:

Land revenue.
Excise.
Stamps.
Irrigation.
Forests.
Registration.

A striking feature of the above allocation will appear to be that the Central Government has been given heads of income dependent on commerce and industry, while the Provincial Governments are largely dependent on agricultural progress. It follows that as commerce and industry expand—which must happen in the normal course of events—the income of the Central Government must expand. *Per contra*, the tendency, in a densely cultivated country like India, for land revenue is to remain stationary or show very little expansion. Excise revenue also is diminishing steadily as a result of prohibition propaganda, and, as remarked by the Simon Commission, 'there is no direction in which the Provinces can look for a substantial or even a continuous increase in revenues, except under the heading of "Stamps"' (vol. ii, paragraph 256).

To a certain extent, the allocation of resources is determined by the classification of subjects. The principle observed is that the whole of the expenditure upon, and the whole of the revenue accruing from, a Central/Provincial subject, should be borne by, or handed over to, the Central/Provincial Government. For instance, if customs is classed as federal, the entire revenue as well as expenditure under this head will be federal. And, similarly, if land revenue is classed as a provincial subject, the entire receipts as well as expenditure under this head will be provincial.

The classification of subjects is the same for all the Provinces. Owing, however, to the fact that conditions in all the Provinces are not alike, and that in previous financial settlements some Provinces were generously treated while others found themselves left with inadequate resources, there are glaring inequalities in the financial position of the Provinces *inter se*. The following table brings such inequalities vividly to notice:

Province	*Population in millions*	*Total Provincial revenue (Crores of rupees)*	*Total Provincial expenditure (Crores of rupees)*	*Total Expenditure on Education, Medical Relief, and Public Health (Crores of rupees)*	*Proportion of col. 3 to col. 2 (income in rupees per capita)*	*Proportion of col. 5 to col. 2 (expenditure in rupees per capita)*
1	2	3	4	5	6	7
Madras .	42·3	17·56	17·71	3·98	4·15	0·94
Bombay .	19·3	15·72	16·00	2·95	8·14	1·52
Bengal .	46·7	11·85	11·93	2·31	2·53	0·49
United Provinces	45·4	13·09	12·39	2·57	2·88	0·56
Punjab .	20·7	12·54	11·49	2·48	6·05	1·19
Bihar and Orissa .	34·0	5·85	6·12	1·41	1·72	0·41
Central Provinces	13·9	5·56	5·27	0·79	4·0	0·56
Assam .	7·6	2·84	2·98	0·54	3·73	0·71

(Figures relate to 1929–30; vide *Simon Commission Report*, vol. i, paragraph 416.)

It will be observed from the above table that the income per head of population in each Province shows large variations, from over 8 rupees in Bombay to 1¾ rupees in Bihar and Orissa. For this reason, mainly, the Provinces show striking discrepancies in administrative progress. Bengal, for instance, with general conditions very much similar to Bombay, is able to spend only one-third the amount of the latter on education, medical relief, and public health. And so on, with other Provinces. Some Provinces have thus come to be regarded as 'backward', which must be deplorable in the interest of the country as a whole.

The problem of allocation of resources is by no means an easy one. Circumstances change so unexpectedly in India that it is very difficult to make any forecast of future revenue even for the next four or five years. The Meston Committee estimated that every Province would, under its scheme, gain increased spending power in proportion to its needs. The budgets for the very next year, however, began with large deficits, thus falsifying all calculations made by the Committee. The Provinces were forced to establish financial equilibrium by drastic economy and recourse to additional taxation. And, in spite of all their efforts, large deficits in every Province are the order of the day.

Naturally, the Provinces are very dissatisfied with the existing allocation of resources. The provincial Governments are in charge of nation-building activities, on which there is unlimited scope for useful expenditure. The expenditure on education is inadequate in every Province and the need for universal primary education is admitted by everybody. The inadequacy of expenditure on medical relief was recently criticized in the Bengal Legislative Council—and the same is true of other Provinces also—

when numerous instances were given of patients having to be taken from one hospital to another in Calcutta and finally left in their houses, owing to lack of accommodation in the hospitals. A beggar patient was, it is said, picked up on the road by an ambulance, but as there was no accommodation in any hospital, he had to be put back on the road. The development of agriculture, which is most urgent, is also held up for lack of funds. The development of industries is necessary for the relief of the pressure of population on the means of subsistence, which is creating acute political discontent, but the Ministers in charge of Industries have been unable to get the requisite funds from the provincial Finance Departments. The evidence before the Muddiman Reforms Enquiry Committee of 1924 clearly shows that the difficulty arising from finance has formed one of the main obstacles to the success of the reforms in the Provinces. If the new constitutional arrangements are to confer a substantial advantage on the people of the country, '*the revenues of the Provinces need to be increased by something like 50 per cent*'. (*Simon Commission Report*, vol. ii, paragraph 263.)

The Taxation Inquiry Committee of 1924–5 was asked by the Government of India to indicate the theoretically correct distribution of taxes between central and provincial and in reply they pointed out that there was no system generally accepted as the theoretically best system of taxation. When we study the financial systems of different federations we find very little similarity between them.[1] The distribution of resources between the Federal Government and the component States is not based upon considerations of pure theory, but is determined in each case,

[1] A brief study of the allocation of sources of revenue in the federal systems of the United States of America, Canada, Australia, South Africa, and Switzerland is given at the end as an Appendix to this chapter.

to a very large extent, by the special circumstances governing the formation of each federation. As the Taxation Committee have remarked, 'the systems adopted by different countries have been moulded by widely differing influences emanating from the past history of the particular States, the psychology of their people, the religious differences prevailing among them and their trade and foreign relations with neighbouring States'.

What they go on to say on the same subject is of special significance in view of the participation of Indian States in the Federation: 'in the forming of federations, *the dominant factor in each case was what the independent States which came together were willing to give up.*'

This will explain the recommendation made by the Peel Committee for the retention of internal customs by the Indian States and their general exemption from direct taxation, while the former has been prohibited in the case of the Provinces. Insistence is rightly laid on this point in both the Percy and Davidson Reports, which has, however, given rise to dissatisfaction and misunderstanding in certain quarters in British India. It is all the same true that no financial adjustment between the Centre and the Provinces or between British India and the Indian States could work which sought to wipe out the past and started off with a clean slate. As the Percy Committee puts it, 'the conception of maintaining the *status quo* in non-essentials is a better guide to policy than any ambitious ideals of equality or uniformity'. The same observation is to be found in the Davidson Report:

> 'It is therefore apparent at the outset that the ideal represented by the principle of uniformity or equalization of burdens and benefits is one not likely to be easily attained, and no useful purpose would be served by a refusal to recognize existing facts.'

While holding the general view that in matters of allocation of resources abstract theory was no reliable guide and facts as they existed had to be faced, the Taxation Committee observed that the following general tendencies could be traced from a study of the systems of federal States:

(i) Indirect taxes, with the possible exception of stamp duties, are commonly regarded as suitable sources of central taxation, for the reason that their exact incidence cannot be ascertained.

(ii) Taxes on corporations are commonly central, because the operations of large companies often extend throughout the country, and adequate and uniform administrative supervision of such organizations is desirable.

(iii) A personal or general income-tax is generally regarded as a source of State revenue.

(iv) Taxes on property are seldom federal and tend to pass increasingly from State to Local.

The recommendations made by the Peel Committee are on the lines of (i) and (ii) above. As regards (iii), they accept the principle that the Provinces are entitled to a share of the personal income-tax, but the Percy Committee have reported that the Federal Government would be left with a large deficit if the whole of this tax was made over to the Provinces. This point will be dealt with later on in this section.

It is generally accepted that:

'Federal resources should, as far as possible, be confined to revenues derived alike from the inhabitants of the Provinces and of the States, and which can be raised either without any action on the part of the individual States or by an agreement with them of simple character, readily enforceable' (Peel Committee Report).

This principle implies, very roughly, that the federal sources of revenue should be confined to 'indirect' taxes, which are generally levied in the shape of customs or excise duties. It is the invariable rule in federal States that customs duties, including export duties and excise duties, are exclusively in the hands of the Federal Government, and this is true even of those federations where the federal authority is weakest. This arrangement involves freedom of inter-State trade and its control by the Central authority, with a view to maintenance of uniform conditions over the whole of the country, and in all cases the desire to secure freedom of inter-State trade has been one of the principal motives for federation.

Duties upon goods entering or leaving the country are very closely inter-connected with functions which are esssentially federal, such as the negotiation of treaties with foreign countries, and it is therefore desirable that the Federal Government should have full control over such taxes. It is obvious that there should be no conflict, in the exercise of powers of indirect taxation by Provinces or States, with the international obligations of the Federal Government under any Commercial Treaty or International Convention.

If there were a clean slate to write on, it would follow that no State or Province, after joining the federation, should be in a position to levy internal customs or tax the consumption of other States or Provinces. To permit internal tariff barriers would seem the very negation of federation.

So far as the provinces are concerned, the application of this principle presents no difficulty, but it might conceivably be regarded with disappointment by advocates of inter-provincial tariffs. Bengal is already raising her voice for protection against Bombay cotton goods with a view

to establishing a cotton-textile industry of her own. Provinces like Assam, which at present levy import duties on timber and other forest produce under section 39 of the Indian Forests Act, will also be affected by such a recommendation. The Indian States stand to gain, inasmuch as Provinces will be debarred from imposing duties on State products entering provincial territory, which some of the Provinces seem to be contemplating.

So far as Indian States are concerned, hard facts have got to be recognized. There is as yet no taxable middle class in the majority of the States and indirect taxation is the chief source of revenue. It is financially out of the question for any of them to give up their inland customs without receiving any compensation. The Peel Committee accordingly reported that this anomaly might be allowed and the existing rights of the States in the matter left undisturbed.

In relation to maritime customs, the Davidson Committee recognize that they 'find it hard to reconcile with the ideal of a true federation the retention by any federal unit of its own sea customs receipts'. They also realize that there is no analogy between letting States levy inland customs and letting them appropriate sea customs, for in so far as the former are levied on goods from overseas, they are an addition to the duties already paid at the ports, and their collection by the inland States does not subtract from the general customs revenues of the federation.

But here again principle has to be sacrificed, in view of the fact that 'no port-owning State is likely to surrender its customs rights, even in return for full compensation'. The Davidson Committee propose as a compromise that maritime States should be allowed 'to retain the duties on goods imported through their own ports for consumption by their own subjects'. The maritime States are not likely

to agree, but so far as the British-Indian point of view is concerned, it only means the perpetuation of the *status quo* and should therefore be welcomed. No hasty inference regarding inequality of contribution to common burdens by the States vis-à-vis British India need be drawn just from this single instance of customs receipts. The economic contribution of the States should be judged as a whole, and the reader should therefore suspend judgement until he comes in this section to the chapter dealing with the economic case of the States as a whole. It is in this way alone that the question can be viewed in its proper perspective.

Some persons are of the opinion that if the federal authority depends only upon indirect taxation the burden will fall more particularly upon the poorer classes, and there is no reason why the richer classes should be exempted from making their contribution to the heavier federal burdens through direct taxes. They therefore suggest that direct taxation should also be included within the sphere of the Federal Government. Federal Governments in other countries—as will appear from the appendix to this chapter—depend on direct as well as indirect taxes for their support, and it is by a judicious combination of both direct and indirect taxes that attempt is made to secure the incidence of taxation according to 'ability to pay'. At one time, income-tax was regarded as a source of State revenue, but in most of the federations taxes on income are now levied by both Federal and State Governments. The reason why the Peel Committee have made the recommendation in favour of exclusive resort to indirect taxation by the Federal Government is that the Indian States are unable to agree to the imposition of any direct taxation by the federation on their subjects. They would regard such action as a serious infringement of their

sovereign rights. They also object to being deprived of considerable resources which they could collect for the administration of their territories. It would have been impossible to secure the entry of the States into the federation if they had been asked to give up their customs revenue, and it would have been particularly unjust to impose fresh burdens in the shape of general income-tax on them, considering the fact that they are already complaining that they pay far more towards common objects of expenditure than can equitably be claimed from them. That this complaint is not unreal will be apparent from a perusal of the chapter dealing with the economic case of the States.

In the light of the principles enunciated above, we will pass in rapid review the principal direct and indirect taxes with a view to their allocation:

Import Duties.

In view of the observations made above, there will be no hesitation in favour of allocating these duties to the Federal Government.

Export Duties.

There are only two important duties on exports in the present customs tariff, viz. on jute and rice. The duty on rice will practically disappear with the separation of Burma from India, as 90 per cent. of the export of rice is from Burma. The only duty to consider is the jute duty. There is a strong feeling in Bengal that in view of (i) the objection in principle to export duties as such, which are forbidden in some federations, and (ii) the depression through which the jute industry is passing, the export duty should be abolished altogether.

In case this is not feasible, it is urged that the revenue

from this source should be wholly or partly provincialized, as it is drawn entirely from one Province.

The objections to such a course are:

(i) The revenue derived from this source amounts to over Rs. 4½ crores[1] (on the basis of figures for 1929–30) and cannot be forgone by the Federal Government, which even under the present allocation of resources would be dependent on contributions from the constituent units for balancing its budget.

(ii) Jute is an absolute Indian monopoly. The tax falls upon the foreign consumer and not on the home producer and there is, therefore, no theoretical justification for assigning a share of the proceeds of the duty to any individual Province. Export duties, though generally recognized as a pernicious form of taxation, are justified even by economists in cases where the duty is imposed on a real monopoly.

(iii) If the proceeds of a duty are shared with another Government, the consent of that Government must be obtained before effect can be given to any reduction or abolition of duty. The Federal Government, if it shared the receipts with the Government of Bengal, would find it difficult to adapt the duty on jute to the changing requirements of the jute trade, should such a step be found necessary to protect the Indian product against substitutes that might be found for jute.

(iv) If the principle of sharing an export duty were once accepted, it would not be long before Provinces claimed on principle a share in the import duties.

Opium. Opium was at one time a monopoly of the Government of India and was an important source of revenue. An export duty was levied on opium and was

[1] Owing to severe depression in the jute industry, the amount realized in 1931–2 was Rs. 3 crores only.

paid by the people of China. But, owing to international agreements, the export to China has progressively diminished and will entirely cease in 1935. The Federal Government will therefore derive no revenue from export, except what it may get from Burma. For consumption in India, an excise duty is levied which goes to the Provinces.

Octroi and terminal taxes. Octroi and terminal taxes are more or less similar. Both are levied on goods entering municipal areas, the only difference being that while octroi duty is refunded on goods passing through, not intended for consumption within the municipal area, a terminal tax once collected is not refundable. Such receipts are generally appropriated by municipalities. But it is proposed that while octroi may continue to be a municipal item of receipt, a terminal tax may be levied at a low rate for provincial purposes at *every* railway station (vide *Simon Commission Report*, vol. ii, paragraph 274). Such taxes are a serious impediment to trade and commerce and result in considerable harassment of poor people. Public opinion is generally opposed to such proposals. In other countries it has been found necessary to regulate the levy of this form of taxation by statutory rules. The reasons justifying control by the Central Government are briefly as follows:

(i) In the case of import duties an octroi or terminal tax levied on the same articles by local or provincial authorities affects central revenues.

(ii) In the case of terminal taxes, there is no provision for refunds on articles which are re-exported. They, therefore, operate as transit duties and in the case of ports (like Karachi where a terminal tax is in operation) as export duties on the articles shipped at the port.

(iii) Terminal taxes interfere with the railway administration, since the frequent variation of the rates by local

authorities makes the adjustment of railway rates a difficult process. These taxes operate, in some cases, as surcharges on the railway rates.

(iv) These taxes are objectionable from the point of view of incidence, since they are levied on almost all the articles of food consumed by the poorer classes.

It would not be difficult to multiply arguments against such taxes, but the fact of the matter is that indirect taxation can be levied without exciting popular opposition, which has to be reckoned with in all proposals relating to direct taxation. Even though terminal taxes are indefensible in theory, a provincial government may in a period of financial difficulty find it so much easier to follow the line of least resistance and levy a terminal tax, should it be permitted to do so.

The Percy Committee also consider such taxes objectionable and are of opinion that, as suggested above, municipalities and provinces, if permitted to raise such taxes, 'should be allowed to do so only within limits laid down by the Federal Legislature'.

Excises.

These duties may be either federal or provincial, according to the locality of consumption. Where the locality of consumption cannot be traced, an excise duty must be federal.

In the case of the tax on salt, it is not easy to trace consumption. The duty is levied at places where production is concentrated, but consumption is spread all over the country, as there are some Provinces where practically no salt is produced.

In the case of the excise duty on petroleum and kerosene oil, it cannot be said that duty follows consumption. The tax is levied at the refinery, and though at the time of levy

the destination of a particular consignment may be known, it cannot be guaranteed that it will be consumed in a particular area.

In the case of the excise duty on liquors, narcotics, and drugs, duty usually follows consumption.

According to the principle enunciated above, it follows that the excises on salt, petroleum, and kerosene oil must be federal, while the excises on alcohol, narcotics, and drugs must be provincial.

Owing to the strong feeling in favour of prohibition, the excise on liquors, narcotics, and drugs, which to-day yields a total revenue of £15 millions to the provinces (amounting roughly to one-fourth of the total provincial revenues) is threatened with extinction. Its abandonment, though urged on much the same grounds as the abandonment of the opium export duty, will place a severe strain on provincial finances whenever it comes about.

The Percy Committee thinks that in pursuing the above policy, Provincial Governments are sacrificing revenue without effecting a corresponding restriction of consumption, as illicit distillation is increasing. Any Province which deliberately forgoes revenue in this manner cannot, according to them, 'fairly ask for special treatment in the distribution of income-tax at the expense of other Provinces'. The reference to Bombay in this quotation will be obvious to those who know.

Excise on tobacco. An excise duty on tobacco has frequently been suggested as a source of provincial revenue. There has lately been a marked development in the production of cigarettes in India, which is concentrated in a few large factories. The manufacture of 'Beeris' (indigenous hand-made cigarettes) on a large scale, however, would make the taxation of factory-produced cigarettes an impossibility. It will also not be feasible to levy a tax on

unmanufactured tobacco which is smoked by the poorer classes of the population. In accordance with the principle of duty following consumption, an excise on manufactured tobacco (if levied) would be federal, as the factory-produced cigarettes are consumed all over the country.

The Percy Committee is also of the opinion that an excise duty on manufactured tobacco cannot be levied in the near future. They are opposed to levying a duty on the cultivator, but experienced administrators like Sir Louis Dane think it quite feasible to tax the cultivation of tobacco by an acreage rate in the same way as in the old days opium was taxed. According to him, such a duty in the Punjab—of which province he has special knowledge—would not be objected to by the Sikhs (whose religion forbids smoking) nor by the Muslims, who regard tobacco as exercising a dulling influence on agricultural energy.

Excise on matches. Allied to the proposal for an excise duty on manufactured tobacco is the suggestion to levy an excise duty on matches. On account of the prohibitive tariff on imports of matches, a large local industry has grown up. An idea of the growth of the local industry can be obtained from the fact that the yield of the import duty has fallen from Rs. 172 lakhs in 1922 to Rs. 10 lakhs in 1930–1. As the factories are concentrated in a few towns, but supply the demand of the whole of India, an excise on matches would form an item of federal revenue. Factories situated in Indian States (Mysore, Baroda, and Kashmir) would also be subject to such a duty.

The Percy Committee regard this as a very suitable item of new taxation—in fact they think there is no other, so far as the Federal Government is concerned. They, however, take into account only the proceeds from British India, as they feel that the States will not agree to proceeds raised within their territories being made over to the

Federal Government. If the States did adopt such an attitude, it would arouse hostility and criticism from British India. In any case, it would be necessary to secure the co-operation of the States, so that the duty be levied at a uniform rate throughout the country. Otherwise, if an excise duty was imposed in British India and there was no such levy within the territories of Indian States, there would be a premium on factories leaving British India and establishing themselves in Indian States.

Direct Taxes.

While there is general agreement that indirect taxes are eminently suitable as sources of federal income, there is no similar unanimity regarding the allocation of direct taxes exclusively to the Provinces. In India there are two difficulties, one practical and the other theoretical, in accepting the proposition that direct taxes must all go to the Provinces:

(1) The federal income, unless supplemented from direct taxes like the income-tax, will not be sufficient to meet the federal expenditure. This consideration has become more important now than ever before. As was pointed out by Sir George Schuster in his budget speech for 1932–3, the return from customs duties is showing signs of diminution as they are becoming more and more protective in character. In future this tendency may become even more marked than at present.

(2) A tax on income collected in one Province may really have been earned in other Provinces and consequently the collecting Province has no right to appropriate the whole of the proceeds. On this ground the corporation tax (now called the super-tax on companies) must be regarded as federal.

A tax on personal income is somewhat different in

character to a tax on corporations, and should, as recommended by the Taxation Committee, subject to the exigencies of federal finance, be regarded as a provincial head of revenue. The necessity for uniformity in the taxation of personal income should be recognized by keeping it subject to Central legislation, just as in the case of 'commercial stamps', which though allocated as provincial is subject to legislation by the Centre, in the interests of uniformity of conditions affecting trade and commerce in the country.

Land Revenue and Irrigation.

These must obviously be provincial, as their assessment and collection intimately concerns the whole administration in rural areas.

Forests.

Forests must obviously be a provincial head of revenue.

Commercial Undertakings.

Federal commercial undertakings like railways, posts, and telegraphs must be federal, and provincial commercial undertakings provincial. The Posts and Telegraphs Department is really not a revenue-producing department at all. In the federal budget forecast in Chapter III the amount shown against this department is 'Nil'. That is because of the recognized policy of so adjusting rates that receipts will just balance expenditure.

Stamps.

So far as judicial or court fee stamps are concerned, there is general agreement that they should form an item of provincial revenue. There is, however, some difference of opinion with regard to commercial stamps which some

would allocate as federal and others as provincial. It is said that stamp duties, 'relate to matters of trade and consequently fall under the provisions of the constitution which provide for uniformity in matters affecting inter-State trade, in so far as it is concerned with stamps on business transactions' (*Taxation Enquiry Committee Report*, paragraph 508). The Peel Committee has expressed no definite opinion on the point. So far as legislation for British India is concerned, the subject must be federal. The Percy Committee are in favour of letting this item remain as provincial. They think that 'there are obvious difficulties in the way of separating stamp duties into two classes, commercial and non-commercial. Moreover, the total yield of commercial stamp duties in 1930–1 was slightly more than one crore, of which 40 per cent. was received by Bombay and 27 per cent. by Bengal. The yield on account of personal income-tax is about 10 crores. So it would not be possible to balance the federal budget by federalizing commercial stamps and provincializing personal income-tax, as was thought possible in the Peel Committee Report. Also, the loss of revenue resulting from the federalization of commercial stamps would be unevenly distributed and would be felt most severely by those very Provinces—Bombay and Bengal—which are clamouring loudly for larger resources.

As certain denominations of postage stamps are also used for revenue purposes, it becomes a matter of difficulty to apportion amounts among Provinces on account of sales of unified stamps used for revenue purposes. It may therefore be considered whether it would not be worth while to have altogether separate stamps for revenue purposes and to allow no postage stamps to be so used. There may be some inconvenience to business and trade, but it will facilitate the task of commercializing postal

accounts and also remove a cause of friction between the Central and the provincial governments. It would be in conformity with the principle that there should be as few points of contact as possible between the various partners of the federation, within their respective spheres.

Death Duties.

Death duties are closely connected in their nature and administration with income-tax, and in common with the income-tax exhibit the conflicting claims of origin and domicile. It is not an easy matter to ascertain their correct apportionment as between Province and Province, and there is a very good case for regarding the duties as a contribution for the protection afforded to property by the Central Government. There is thus, in abstract theory, a great deal to be said for making the tax an item of Central resources. A study of federal systems does not, however, bear out this conclusion. Death duties in most federations are wholly assigned to the constituent States or Provinces, but general legislation for the regulation of the tax has been found necessary in some countries to avoid double taxation. In the United States of America, both the Federal and the State Governments levy succession duties. In Canada and Switzerland, the Provinces and Cantons alone levy them; while in Australia both the Commonwealth and the States imposed death duties until 1926–7, when it was decided to hand them over wholly to the States. The question has frequently been discussed in India, and a proposal to impose such duties in Bombay was recently negatived by the local legislature. It is doubtful whether the yield from such a duty in India would be at all commensurate with the trouble involved in its collection. The system of joint coparcenary property and the law of survivorship which prevail in India make

it difficult to impose a tax of this nature on the Hindu community which is the largest community in the country. On socialistic principles, however, there is no reason why the propertied classes should not contribute their proper share to the cost of the administration. An examination of the heads of Central and provincial revenue would reveal a striking disproportion between direct and indirect taxation. At present, the agriculturist and the poorer sections of the community contribute far more than the comparatively well-to-do classes and death duties are a very effective instrument in redressing the balance and placing the burden on the broadest shoulders in the realm.

It would be far better if legislation on the subject were Central, as in the case of commercial stamps. It is at present provincial.

Taxation of Agricultural Income.

This is another frequently suggested source of provincial income. It is dealt with fully in paragraphs 257–71 of the *Taxation Committee Report* and paragraph 269 of the *Simon Commission Report*, vol. ii. Such taxation is justified on the ground that in the Provinces where there is a permanent settlement, land revenue has the same economic character as a mortgage or tithe rent, and in other Provinces also there is the same tendency for land revenue to remain fixed, and it is well known that land revenue does not respond (except in the cases of fresh assessments in Provinces where new land is being brought into cultivation by irrigation) to variations in the produce of the land. This taxation is also justified on the socialistic ground of making the 'idle rich' contribute to the public exchequer. There are, however, strong objections to such a measure on political grounds, as it would alienate the sympathies of the big landowners who are valuable allies

of the Government. On other grounds too, the tax is not free from objection. It would operate unfairly against those who have purchased permanently settled estates at their full market value and those with whom temporary settlements have been concluded at full rates. It would, moreover, be difficult to assess those whose agricultural income is derived mainly from their own cultivation.

Summary of above Conclusions.

On the basis of the survey of direct and indirect taxes made in the preceding paragraphs, an allocation of resources to federal and provincial may be made as under.

FEDERAL.

External customs including export duties, barring the special rights of maritime States and of certain treaty States like Kashmir.
Salt.
Export opium, and excises on articles on which customs duties are imposed (with the exception of excises on alcohol, narcotics, and drugs).
Federal railways.
Federal posts and telegraphs, and other commercial undertakings.
Profits of federal currency.
Corporation taxes.

PROVINCIAL.

Land revenue.
Irrigation.
Excises on alcohol, narcotics, and drugs.
Stamps (subject to Central legislation, in the case of commercial stamps).
Forests.
Provincial commercial undertakings.

Personal income-tax.
Terminal tax (if any).
Tax on agricultural incomes (if any).
The following taxes in the Scheduled Taxes Rules:

1. A tax on land put to uses other than agricultural.
2. A tax on succession or on acquisition by survivorship in a joint family (subject to legislation by the Centre).
3. A tax on any form of betting or gambling permitted by law.
4. A tax on advertisements.
5. A tax on amusements.
6. A tax on any specified luxury.
7. A registration fee.

APPENDIX

The main heads of revenue in the federal systems of the United States of America, Canada, Australia, South Africa, and Switzerland are very briefly indicated in this appendix for the convenience of the student of Indian federal finance. Subsidies and contributions from the Federal Government to its units or vice versa have been omitted, as they are really transfers of income and cannot strictly speaking be called 'sources of revenue'. Detailed reference will be necessary for further investigation, if desired. Necessary information will be available from the annual official reports prepared by the government of each country and the statute containing its political constitution.

THE UNITED STATES OF AMERICA

The general rule, applicable to taxation as to everything else, is laid down in the tenth amendment of the American Constitution given below:

'The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.'

According to the above article, the residuary power of taxation lies with the States and only such sources of revenue belong to the Federal Government as have been specifically allotted to it by the Constitution.

The allocation of resources as contained in the Constitution is as under:

1. The States are debarred from levying without the consent of the Congress any imposts or duties on imports or exports except what may be absolutely necessary for executing their inspection laws; and the net proceeds of all duties and imposts allowed by any State on imports or exports are for the use of the treasury of the United States and all such laws are subject to revision and control of the Congress—Article I, section 10 (2) of the Constitution.

2. The Congress is authorized to levy and collect taxes, duties, imposts, and excises to pay the debts and to provide for the common defence and general welfare of the United States but all such duties, imposts, and excises must be uniform throughout the United States—Article I, section 8 (1) of the Constitution.

3. No tax or duty can be levied on articles exported from any State—Article I, section 9 (5) of the Constitution.

4. Under Article I, section 2 (3) of the original Constitution, direct taxes were to be apportioned among the several States according to their respective numbers. This meant that the Federal Government could not enjoy the receipts of any direct taxes, which came to be regarded as the particular domain of the States. As this restriction led to great inconvenience, it was removed in 1913 by the sixteenth amendment to the Constitution which runs as follows:

'The Congress shall have power to levy and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration.'

Beyond the above provisions there is no allocation of resources in the United States. Briefly stated, the position is as follows:

The Federal Government alone can levy customs duties

(other than export duties which are barred absolutely) and excises.

In regard to direct taxation, both the Federal and the States Governments have an absolutely free hand and in practice direct taxes (sometimes overlapping one another) are levied by both.

The main sources of federal income are:

Income-tax.
Customs.
Internal revenue, including excises and succession duties.

The main sources of income of the States are:

The general property tax.
Corporation tax.
Inheritance tax.
Income-tax.

CANADA

The Canadian Constitution proceeds on the principle that the residuary power vests in the Dominion Government and not in the Provinces. Under section 92 of the Constitution, the sources of provincial revenue are:

1. Direct taxation within the Province for provincial purposes.
2. Sale of public lands belonging to the Province.
3. Licenses for the purposes of revenue.

Under section 91 of the Constitution, the Dominion Government is empowered to raise money by any mode or system of taxation and may tax the same subjects as the Provinces, though it does not appear to have done so.

The main heads of income of the Dominion Government are:

Customs.
Excise.
Income-tax.
Sales tax.
Business profits tax.

The main heads of income of the Provinces are:

Fees.
Lands, Mines, and Forests.
Succession duties.
Corporation taxes.
Licences.

AUSTRALIA

The Australian Constitution is modelled on that of the United States of America, viz. that the residuary powers in fiscal and political matters rest with the States. Under the Constitution, the only allocation of sources of revenue is that customs and excise duties are reserved to the Commonwealth. Otherwise, the powers of taxation of the Commonwealth and the States are concurrent. Direct taxes are levied both by the Commonwealth and the States, and no attempt is made to separate the sources of taxation. All indirect taxation is as a rule taken by the Commonwealth. The Royal Commission on Taxation appointed in 1921 reported that it was only by a delimitation of spheres, or allocation of subjects of taxation between the Commonwealth and the States that an ordered and satisfactory system of taxation could be brought into being in Australia. This is, however, not within the range of practical politics, as the States will not surrender their existing powers.

The example of Australia should be a warning to the advocates of concurrent jurisdiction in the field of taxation to the federation and its constituent units in the case of India.

The main heads of income of the Commonwealth are:

Customs.
Excise.
Land tax.
Estate duty.
Income-tax.
Entertainments tax.

The main heads of income of the States are:

Probate and Succession duties.
Other stamp duties.

Land tax.
Income-tax.
Assessments tax.
Ability tax.
Dividend tax.
Company tax.
Licences.
Public undertakings (Railways and Tramways, &c.).

SOUTH AFRICA

The Constitution of South Africa is of great interest to India, as the Provinces bear very nearly the same fiscal and political relation to the Central Government in South Africa as they do in India. The Centre is supreme in all essential matters in both countries. The Union is in charge of all the important sources of revenue, such as:

Customs.
Excise.
Income-tax.
State and Succession taxes.
Stamp duties.
Land revenue.

The sources of revenue assigned to the Provinces (under the Financial Relations Act of 1925) are the following:

Hospital fees.
Licence fees for dogs, motors, &c.
Tax on vehicles.
Amusement or Entertainment tax.
Auction duties.
Licence fees from totalisators and other taxes on betting.
Taxes on persons other than companies and the incomes of persons other than companies, subject to certain limits.
A tax on companies other than mutual life insurance companies, subject to certain limits.
A tax on the ownership of immovable property but not on transfers or sales thereof.

Licence fees in respect of the importation or sale within the Provinces of goods from beyond the borders of the Union.

Receipts of a miscellaneous nature connected with matters entrusted to the Province.

The above taxes bear a family likeness to the taxes which Provinces can levy in India under the Scheduled Taxes Rules.

SWITZERLAND

Under the Swiss Constitution, the residuary powers are vested in the Cantons, which exercise all fiscal powers which are not expressly reserved to the Federal Government.

The bulk of the federal revenue is derived from indirect taxes, whereas the bulk of the revenue of the Cantons is derived from direct taxes. The receipts from certain heads of revenue are shared between the Federation and the Cantons.

The main heads of revenue of the Federal Government are:

Federal property.
Customs.
Posts and Telegraphs.
Public monopolies.

The main heads of revenue of the Cantons are:

Income-tax.
Property tax.
Personal taxes.
Death duties and Succession taxes.
Stamps.
Taxes on carriages, automobiles, &c.

Chapter III

THE FEDERAL BUDGET

AFTER the allocation of resources comes the question of balancing the budget. However theoretically correct any allocation might be, unless it satisfies the practical test of making the two sides of the account balance, it must be of little interest to those engaged in constructive work.

Assumptions and Omissions in the Percy Committee Budget Forecasts.

The work done by the Percy Committee in this connexion is of the greatest value and must be the starting-point of all further investigations. What do they say?

They assume that:

(i) the present depression will come to an end by 1935–6, and that there will follow a period of reviving trade accompanied by a gradual increase of prices which, if they do not reach the pre-slump level, will rise appreciably higher than the level now prevailing;

(ii) Burma will be separated from India;

(iii) there will be only one budget for federal and central (purely British-Indian) heads of revenue and expenditure, and not two;

(iv) Bombay will not be responsible for Sind, which will be constituted a separate Province; nor for Aden.

(v) the cuts in pay of all servants of the Government which have been made for a limited period will be withdrawn;

(vi) the special surcharges on customs, income-tax, and salt at present in force will be discontinued;

(vii) the Provinces will be responsible for expenditure on their own accounts and audit.

The Percy Committee have also made no provision, owing to lack of definite information at the time, for:

(i) additional expenditure directly due to the establishment of a federal system;

(ii) adjustment of the financial claims of the States;

(iii) additional expenditure due to creation of new Provinces, like Sind and Orissa. They have provided for the subvention from Central revenues to the newly created North-West Frontier Province.

(iv) the expenditure to be incurred on the Constitution of a Federal Court.

In view of the necessary assumptions and omissions underlying their budget forecasts (federal and provincial), the Percy Committee have suggested that, immediately before the establishment of the federation, their conclusions should be reviewed in the light of the information then available. What is attempted in this chapter is a review of their work in the light of the information available till the middle of August 1932.

The Federal and Provincial Budget Forecasts.

Below is given the Federal Budget forecast for 1935–6, as prepared by the Percy Committee. It will be observed that even if no new sources of revenue are acquired, the Federal and Provincial Governments taken together will have adequate resources to balance their budgets, if the assumptions on which the forecasts are prepared are realized.

But in view of the omissions of necessary additional expenditure in the federal forecast, the impracticability of taking moneys already enjoyed by surplus Provinces for the purpose of giving them to deficit Provinces, and the

Revenue	*Rs. (lakhs)*		Expenditure	*Rs. (lakhs)*
Customs	51,20		Debt Services	
Collection	90		Interest (net)	11,25
			Sinking Fund	6,50
Net	50,30	50,30	Posts and Telegraphs (net)	Nil
Salt	6,70		Military Budget (net)	47,00
Expenditure	1,15		Frontier Watch and Ward	1,70
Net	5,55	5,55	Civil Administration, including territorial and political pensions, but excluding other pensions and cost of collecting revenue, and allowing 60 for provincialization of accounts and audit	6,85
Opium	78		Pensions	2,65
Manufacture	73		N.W.F.P. Subvention	1,00
Net	5	5	Civil Works	1,60
Railways (net)		5,00	Chief Commissioners Provinces and Central Areas	2,86
Currency and Mint (net)		3,80	Revenue	1,31
Miscellaneous:			Net	1,55
Ordinary	1,66		Total Expenditure	80,10
Reparations	30			
Total	1,96	1,96		
State contributions	74	74		
Income-taxes	18,00			
Collection	80			
Net	17,20	17,20		
Total Revenue		84,60		

Surplus Rs. (lakhs) 4,50.

The provincial forecasts are as under:

Province	*Surplus (+) or Deficit (−) Rs. (lakhs)*
Madras	− 20
Bombay	− 65
Bengal	−200
United Provinces	+ 25
Punjab	+ 30
Bihar and Orissa	− 70
Central Provinces	− 17
Assam	− 65
Total ±	−382

or less than the federal surplus.

further imperative need of giving all Provinces adequate resources of an elastic character to meet pressing expenditure on nation-building activities, it is proposed by the

Percy Committee that the Federal Government should levy an excise on matches which would yield Rs. 250 lakhs from British India and another Rs. 50 lakhs from factories situated in Indian States. Disregarding the latter, the federal surplus would be increased to Rs. 700 lakhs.

This surplus the Committee propose to utilize as follows:

(1) Two hundred lakhs to expenditure on account of:
   (*a*) adjustment of financial claims of the States;
   (*b*) separation of Sind; and
   (*c*) establishment of a federal system.
(2) Rs. 500 lakhs[1] to placing additional resources at the disposal of the Provinces.

After the above steps are taken, the financial position of the Federal and provincial Governments would be as below:

Federal Government. Such surplus as may be left after providing for expenditure on items (*a*), (*b*), and (*c*) above.

Provincial Forecast.

Province	*Surplus* (+) *or Deficit* (−) *Rs. (lakhs)*
Madras	+48
Bombay	+54
Bengal	−50
United Provinces	+70
Punjab	+64
Bihar and Orissa	−31
Central Provinces	+ 5
Assam	−54

There would still be three Provinces, viz. Bengal, Bihar and Orissa, and Assam, which would be deficit under the above arrangement, and it is proposed to remedy

[1] The manner in which these additional resources are proposed to be made available to Provinces will be dealt with in Chapter V.

this by spreading the charge over the other Provinces, i.e. reducing their surplus.

By this device (which will be discussed in Chapter V) the financial position of the Provinces would be as below:

	Surplus (+) or Deficit (−) Rs. lakhs
Madras	+22
Bombay	+ 9
Bengal	nil
United Provinces	−53
Punjab	+51
Bihar and Orissa	+ 2
Central Provinces	+ 5
Assam	−36

Assam would even then be deficit and the case of this Province would have to be specially considered.

United Provinces and Punjab seem to be peculiarly lucky; Bombay is not likely to agree to the proposal that its surplus should be reduced to make good the finances of Bengal, while Bengal would still be in the least enviable position. There is great dissatisfaction in Bengal over the settlement proposed by the Percy Committee, and in view of the acute economic distress and unemployment in that Presidency, the position will have to be reconsidered.

Examination of the Federal Budgetary Position.

We will now proceed to an examination of the Federal Budget forecast. It will be obvious that the forecast will be realized only if the assumptions on which it is based are realized. It is therefore necessary to examine the assumptions themselves.

Assumption No. (i) is that prices will have risen appreciably by 1935–6. This is a vital point. As Sir Basil Blackett said, quite recently, no scheme of federal or any other finance can succeed, nor can any government in any

part of the world produce a balanced budget unless the present price-level is materially raised. Prices cannot be raised by isolated action on the part of India or any single country. This requires international co-operation. India as a producer of primary products is suffering terribly by the fall in prices, but it is impossible to say whether prices will have risen to the extent anticipated by the Percy Committee in 1935–6, and if not, what will be the extent of this probable rise.

Assumption No. (ii) is that Burma will be separated from India. Everything seems to point in that direction.

Assumption No. (iii) is that there will be only one budget for Federal and Central heads of revenue and expenditure. The Committee have treated all Central heads as Federal. This will naturally give the States a voice in purely British-Indian taxation and expenditure. It will also make them liable for possible deficits in Federal budgets due to the inclusion of Central items. As the gains and losses will be more or less equal, the States may not object.

The States were at one time unwilling to take over responsibility for the pre-federation debt, which is a purely British-Indian obligation. But now it seems that they would be willing to take it over if they are satisfied that no portion is uncovered by assets. Had they stuck to their previous attitude, there would have been two budgets, one Federal and the other British-Indian (or Central, as it is called). But now they would probably be satisfied with the assurance contained in the Percy Committee Report (which is signed by two of their own representatives) that the whole of the pre-federation debt is more than covered by the assets that would be transferred to the Federation and consequently the assumption made by the Committee would be realized.

Assumption No. (iv) is that Bombay will be responsible

neither for Sind nor for Aden. This we may take it will be realized.

Assumption No. (v) is that the cuts in pay of Government servants will be restored. This may or may not be realized. The financial position is still extremely uncertain. Anyway, even if it is not realized, the Federal position will not be worse.

Assumption No. (vi) is that the special surcharges on customs, income-tax, and salt will be withdrawn. The same remarks apply to this as to assumption No. (v) above.

Assumption No. (vii) is that the expenditure on accounts and audit will be provincialized. This is inevitable with the grant of autonomy to the Provinces.

Examining all the assumptions together, we see that barring No. (i), which is fundamental, there is nothing to cavil at in the assumptions on which the Percy Committee Report is based. We have now to see whether the Rs. 200 lakhs which they have set aside for necessary additional expenditure will prove adequate. For, if it does not, the Federal Budget will become deficit.

We will now deal with each item which must be included within this figure and give the best estimate available of its probable cost.

Separation of Sind.

The Irving-Harris Committee put the total initial deficit of the separated Province at Rs. 110 lakhs per annum, rising to Rs. 144 lakhs in thirty years, excluding the Sukkur Barrage. Including the Sukkur Barrage, the ultimate maximum net return on which they estimated could not exceed Rs. 24 lakhs per annum, the deficit might *after a term of years* be a little smaller, but they thought that the deficit would never be wiped out. The Brayne Conference,

which was convened during April and May 1932 to discuss the means of overcoming the above financial difficulties, has reported that the initial deficit would be about Rs. 80½ lakhs, instead of Rs. 110 lakhs as worked out by the Irving Committee. The Conference, however, sees very little scope for any substantial increase in the revenue of Sind, nor do they see any possibility of saving money by retrenchment. The only hope of Sind balancing its budget is by a subvention from Central revenues of Rs. 80½ lakhs, which they say will be required 'for some years to come', after the separation has taken place.

Separation of Orissa.

A Committee presided over by Sir Samuel O'Donnell has just submitted its report regarding the financial and other consequences of setting up a separate administration for the Oriya-speaking peoples. The principle of separation has, however, not yet been accepted, as it has been in the case of Sind. The report of the Committee shows that the new Province of Orissa, if constituted, would start with an annual deficit of Rs. 35 lakhs, and that this deficit would increase to Rs. 41 lakhs by the fifteenth year.

As in the case of Sind, there are no means by which this deficit could be overcome within the Province itself, and resort to a Central subvention would be necessary.

We are here concerned only with the financial implications of the above proposals. It is no part of our purpose to discuss whether they are justified or not. But it must be obvious that with the creation of the new Provinces of Sind and Orissa, there will be an outcry for more and a general demand (of which cognisance was taken in the Nehru and Simon Reports) for the revision of provincial boundaries on linguistic and racial lines. Each of these new States would look to the Central Government for

a subvention if, as in the above two cases, its finances are not self-supporting and the strain on the Central Exchequer would thus become intolerable.

Enlarged Franchise and Legislatures.

According to the Lothian Committee's own estimate, the approximate cost to provincial governments of a general election would be in the neighbourhood of Rs. 50 to 60 lakhs. The cost under the present system on the elections of 1929–30 was Rs. 12½ lakhs; or, in other words, the increase in provincial expenditure will be about Rs. 40 lakhs.

The above figure is exclusive of the cost of elections to the Federal Legislature. The Lothian Committee estimate that this would come to approximately Rs. 16 lakhs. The present elections cost Rs. 2 lakhs.

The total cost, therefore, of a general election for the whole of British India would amount roughly to Rs. 66 lakhs; or, about Rs. 20 lakhs per annum, if the Federal Legislature continued for the full five years' term, and every provincial legislature completed the full three years' term. If, however, elections are frequent, as some persons anticipate, the cost will naturally be greater. In the above estimate no account is taken of the increase in governmental expenditure due to the enlargement of the legislatures themselves. Such an estimate must be largely conjectural, but there can be no doubt that if the number of members is nearly doubled, the cost on the present basis (i.e. if the sessions do not last longer and more accommodation and staff are not required) will be proportionately increased. The present Central Legislature costs Rs. 6,70,000 a year, and the Provincial Legislatures cost about Rs. 13,06,000; or altogether about Rs. 20 lakhs per annum. With double the number of members, the expenditure under the new

régime cannot be less than Rs. 40 lakhs. The figures given above may now be summarized as below:

Annual cost.	Rs. *At present.*	Rs. *Under new régime.*
Central elections	66,000	3,20,000
Central Legislature	6,70,000	13,40,000
Provincial elections	4,16,000	16,66,000
Provincial Legislatures	13,06,000	26,12,000
Total	24,58,000	59,38,000

Probable increase in annual expenditure: Rs. 35 lakhs, roughly

Many would consider this a highly optimistic estimate, but it is given above for what it is worth.

Financial Claims of Indian States.

In a paper read before the East India Association on 24th May 1932, Sir Arthur Macwatters, lately Financial Secretary to the Government of India, said that 'the total bill which the States were prepared to present to British India was in the neighbourhood of Rs. 16 crores (£12 millions) a year'. No mention has, however, been made of any such figure in the Davidson Report. It may therefore be treated as out of date, with federation envisaged as the goal. Without attaching any finality to the conclusions of the Davidson Committee, it would be safe to say that whatever sum becomes ultimately payable to the States from the Central Exchequer will not be so formidable as hinted at by Sir Arthur Macwatters. The Davidson Committee estimate the *ultimate* burden on Federal revenues at approximately Rs. 1 crore per annum. This is, however, a gross figure. Against this will have to be set the debits against the States concerned for immunities and privileges they enjoy at the expense of Central revenues. So far as the *immediate* burden on the Federal

budget is concerned, it is not likely to exceed Rs. 50 lakhs, made up as under:

(i) Rs. 12 lakhs, on account of remissions of tributes of individual States, which are in excess of 5 per cent. of their total revenues; and,

(ii) Rs. 37 lakhs (gross) as compensatory credits for returns from ceded territories due to the following States:

	Rs. (lakhs).
Baroda	22·98
Gwalior	11·78
Indore	1·11
Sangli	1·10
Total	36·97

Federal Court.

No estimate has been prepared, but the expenditure is inevitable and is bound to be considerable, both recurring and non-recurring.

Total Additional Expenditure.

Summing up the above items, it would appear that the total additional expenditure which will have to be incurred under the new régime, but for which no provision is made in the Federal budget forecast, prepared by the Percy Committee, amounts to:

	Rs. (lakhs)
Sind	80½
Orissa	35
New elections and legislatures	35
Financial claims of States	50
Federal Court	no estimate
Total	200½

Thus, even on the above extremely modest calculation, the Federal Government would be left with no surplus at all but with a more or less certain deficit, if the expenses

of the Federal Court are included. For anything like a safe financial position, the Federal Government must reckon on a minimum surplus of 5 per cent. of its net revenues (nearly 85 crores) or about Rs. $4\frac{1}{2}$ crores. Such a margin on the present scale of public expenditure is unlikely and the only hope of a successful working of the federal régime lies in a radical overhauling of the entire administrative machinery, civil and military, and bringing it into line with the present-day capacity of the country to pay for it.

Chapter IV

RESIDUARY POWERS OF TAXATION

UNDER the Scheduled Taxes Rules, a provincial legislature may, without previous sanction, impose any of the taxes listed in schedule 1 (already given in Chapter II) for the purposes of the local Government. In all other cases, the previous sanction of the Government of India is necessary, which means that the residuary powers of taxation reside in the Government of India.

An acute controversy has been raging in India over the question of residuary powers in legislation, finance, and administration. The Muslim delegates, in their uncompromising advocacy of provincial autonomy, and the delegates from the Indian States, in their keenness to safeguard the internal independence and sovereign rights of the Princes, are firmly of the view that whatever allocation of resources may be agreed upon should be definitely embodied in the Constitution, and that federal revenues should be strictly confined to the specific items agreed upon to be federalized and that no modification involving any fresh financial burdens on the federating units should be made in such an allocation without their free consent. Or, in other words, the Federal Government should be empowered to levy only such taxes as may be specifically scheduled by common agreement as sources of federal revenue, which means that the residuary powers of taxation should be left with the federating units, namely, the Provinces and the States. In making such a demand, they have a precedent in their favour in Article 69 of the Polish Constitution, which provides as follows:

'The sources of the revenues of the State and of the autonomous federations shall be strictly delimited by law.'

On the other hand, there are persons who think it entirely unnecessary to prepare rigid schedules of taxation for Federal and Provincial Governments. They consider that rigid schedules are not to be found in any federal constitution and that it is absurd to stereotype the system of taxation of the country and thus limit the ingenuity of future Finance Ministers of the Federal and Provincial Governments. All that is required in their opinion is to impose a limitation on the powers of the federating units that they shall not impose taxes, like Customs and Excises, allotted to the Federal Government, leaving the rest of the field for all the partners in the federation to divide as they like.

It is doubtful whether the States will agree to leaving things in such a fluid condition as is suggested above. Besides, the lesson which the history of Australia—where an exactly similar state of affairs prevails, as will be gathered from the appendix to Chapter II—teaches is that without a delimitation of spheres of taxation an ordered and satisfactory system of taxation for the country as a whole is impossible. On the other hand, it is quite obvious that no allocation of resources now made can yield satisfactory results for all times. With new governments may come new policies, which may lead to the abandonment of existing sources of revenue (e.g. salt and excise on intoxicants) or radical alterations therein (e.g. land revenue) or adoption of entirely new sources of income. Changing economic conditions (e.g. fall in agricultural prices such as is now being witnessed) may affect the yield from existing sources and thus necessitate modification in the present allocation much sooner than may be generally expected. To make modification dependent upon the consent of all or even a majority of the federating units would be tantamount to making it impossible and might

lead to a breakdown of the Constitution. Some elasticity is obviously necessary and must be provided in the Constitution. Emergencies may arise in which the Federal Government may have to seek additional resources without delay. There is a suggestion that the Governor-General's certificate should be obtained that a state of emergency exists before the Federal Government could ask for contributions from the federating units. That would be a slur on the good sense of the Federal Government and a negation of responsibility in the Federal Executive. The Federal Government should not be left at the tender mercy of the federating units in a state of emergency. Voluntary contributions from the component elements are really a contradiction in terms. The history of federal income-tax in the United States of America and in Switzerland illustrates clearly the difficulty of relying on voluntary contributions from autonomous Provinces. As it has been recognized that indirect sources of taxation are peculiarly the field of the Federal Government, it would be a good workable rule that all residuary powers relating to indirect taxation should reside in the Federal Government, leaving residuary powers in regard to direct taxation with the constituent units.

It will also be obvious that whatever powers of taxation may be enjoyed by the units of the federation must be subject to the over-riding conditions that they shall not be exercised:

(*a*) so as to conflict with international obligations undertaken by the Federal Government in commercial treaties or international conventions;

(*b*) against the interests of the Federation as a whole;

(*c*) so as to affect injuriously any head of federal revenue; and,

(*d*) to tax the property of the Federal Government.

Condition (*d*) is based on the Canadian, Brazilian and Australian Acts. The immunity of federal property from taxation by the Governments of the constituent units should extend to rates and cesses imposed by local authorities, with the exception of charges which are in the nature of payments for services rendered. On the same analogy, the immunity from taxation should extend to the property of constituent units also, so far as federal taxation is concerned. In other words, neither the Federal nor the Provincial and State Governments should be empowered to levy taxation on the property of the other party.

Chapter V

ADJUSTMENT OF INEQUALITIES

IT is not to be expected that an allocation of resources based on theoretical grounds would by itself yield satisfactory results in giving the Federal and Provincial Governments adequate revenues to meet their expenditure, or place the Provinces financially on a footing of equality *inter se*. After the allocation is agreed upon, the next step is to frame budgets of anticipated revenue and expenditure of each Government for the next five years or so and to see what adjustments are required to give each a good start, both absolutely as well as relatively to the rest. Such adjustments are a common feature of all federations. The methods by which adjustments are usually made are the following:

(*a*) Grants-in-aid to constituent units for specific purposes.

(*b*) Division of the actual proceeds of taxation.

(*c*) Contributions from the Central Government to the Provincial Governments or vice versa, for general purposes, as distinguished from grants-in-aid for specific purposes referred to in (*a*) above.

(*a*) *Grants-in-aid.*

Under the existing Constitution, it is not permissible to devote Central resources to the Provinces or provincial resources to the Centre. This is the logical outcome of the principle of complete separation of revenues, on which the authors of the Montagu-Chelmsford Report rightly laid so much stress.

It is true that no government should be normally dependent on another government for funds to carry on its

ordinary administration. If it has to depend on doles from another government to make both ends meet, the result must be demoralization and a weakening of that government. While this principle must always be kept in view, it is none the less true that in most of the federations no attempt is made completely to separate the sources of revenue of the Federal Government and the constituent units, nor is such a separation considered essential in order to ensure the fiscal autonomy of the units. In the special circumstances of India, it is felt that such a principle works very unfairly as between Provinces and leads to administrative difficulties. Consequently, it is held that it should be possible for the Central Government to help a Provincial Government in special cases in which the latter is unable to meet the expenditure out of its normal resources. Similar considerations apply to a Province making a grant for any purpose to the Central Government. The grant, whether from the Centre to the Province or from a Province to the Centre, should be subject in each case to the assent of its legislature.

Such grants are a common feature in federations. In Canada, for instance, the Dominion Parliament has made large grants-in-aid to the Provinces for constructing and improving highways, though roads are essentially a State matter under the Canadian Constitution. Similarly in Australia, the Commonwealth Government grants annual subsidies to the various States for the provision of hospital treatment for persons suffering from venereal diseases. Even in the United States of America, where the constituent States are fiscally and politically independent of the Federal Government, grants to the States from federal revenues for postal roads, vocational education, social hygiene, and similar internal improvements are quite a common feature of public finance. In this manner,

Federal Governments have found it possible to expand their powers, in spite of constitutional limitations, for, as is shown later on, such grants have always involved some control over the units in regard to their utilization.

It is undoubtedly in the national interest that the Federal Government should, on suitable occasions, be able to utilize any surplus revenues at its disposal, not for the remission of central taxation but for allotment as grants-in-aid to the constituent units, so as to enable them to make more rapid progress with measures of national development than would be possible with the unaided resources of particular units. Similarly, in certain circumstances, it might be better that the Federal Government should raise taxation on a uniform all-India basis and make the proceeds available to the units for national development in a particular direction, e.g., the construction of roads. Though roads are a provincial subject in India, they are badly in need of development. Such development can come only as a result of co-ordination of policy from the Centre and funds contributed on an all-India basis.

Before, however, any such grant-in-aid could be made, two points would require consideration:

(1) the basis on which such grants should be distributed; and

(2) the degree of control by the Central Government in the spending of such grants by the units.

As regards the first question, the Taxation Enquiry Committee have suggested distribution in proportion to population, which they say 'is the basis of the matricular contributions in Germany and of the arrangements made in Canada, Australia, and South Africa'. In view of the fact that such grants would generally be needed by the poorer and more populous units, distribution on the basis

of population seems most satisfactory. 'A distribution in proportion to revenue is calculated to benefit those who need it least, a distribution in proportion to expenditure is calculated to encourage extravagance' (*Taxation Enquiry Committee Report*, paragraph 510).

Regarding the second point, namely, the conditions attaching to such grants, it is reasonable that the authority making a grant-in-aid should be in a position to satisfy itself that the money has actually been spent for the purpose for which it was given. Wherever grants-in-aid are given there is inevitably some degree of control over their expenditure. Under the Canada Highway Act of 1919, the payment of grants to the Provinces for construction and improvement of roads is subject to very definite conditions.

The Canadian Technical Education Act of 1919 similarly prescribes the terms and conditions upon which payments of grants from federal revenues for technical education are made to the Provinces.

In view of the above precedents, there would be nothing derogatory to the position of the constituent units, if the Federal Government of India made reasonable conditions controlling the utilization of such grants.

(*b*) *Division of the actual proceeds of Taxation.*

A division of the actual proceeds of particular classes of taxation may be effected in any of the following ways:

(i) the proceeds may be divided arbitrarily into fractions;

(ii) the tax may be divided into spheres, which may be assigned to one or the other of the authorities;

(iii) both Governments may impose their own taxation, either separately, or through the same agency.

(i) *Division of proceeds into arbitrary fractions.* This is the old system of divided heads which was in force prior to the

Montagu-Chelmsford Reforms. It was done away with in 1921 as it led to interference by the Central Government with the provincial Governments in details of administration.

This method of division was also condemned by the Taxation Enquiry Committee who remarked that it 'has the defects of a subsidy with others added. The subsidy fails if the particular source dries up. The divided authority and interest is an infringement of autonomy and makes for bad administration'.

We may therefore dismiss this method as unsuitable for making adjustments in any scheme of federal finance in India.

(ii) *Division of a tax into spheres.* As instances of this method of division, might be mentioned the following:

(*a*) division of the proceeds of a tax on tobacco, under which the excise duty is credited to the Federal Government, while the units are allowed to levy fixed licence fees on shops for the sale of tobacco; or

(*b*) the allotment of the excise duty on foreign liquor to the Federal Government and the fees for vend to the units; or

(*c*) the allotment of income-tax on corporations to the Federal Government, while the income-tax on individuals is allotted to the units.

This is a permissible method of making adjustments, so long as the respective spheres do not overlap.

(iii) *Double taxation.* This method can be adopted with several variations:

(*a*) The units might be empowered to levy and administer a tax (e.g. income-tax) separate and distinct from that levied by the Federal Government, as is done in Australia and the United States of America in the matter of income-tax, and also in India where some local authori-

ties are empowered to levy taxes directly assessed on income. This method is clearly open to grave objection and cannot be recommended. The existence of two independent taxing authorities operating within the same sphere is bound to give rise to serious difficulties and would cause considerable irritation to taxpayers. The system involves the submission of separate returns to two different authorities and the understanding of the provisions of two different taxing schemes.

(*b*) A tax (e.g. income-tax) might be levied by the Federal Government, which might at the same time levy a comparatively small *centime additionel* (or surcharge) for the benefit of the units. This system prevails as between State and local taxation in France, Belgium, and other European States. The Taxation Committee remark that it would not be suitable as between the Federal Government and its units 'since it would be useless unless the contribution were a substantial amount, and if it were so, conflict of interest might easily arise if both Governments wished to make a considerable enhancement in their shares'.

The above objection would apply equally to the suggestion made by the Percy Committee that 'the Federal Government should have a general power to impose a surcharge for its own purposes on any tax levied by it for the benefit of the units' (paragraph 100); and much more to the other suggestion that 'the Federal Legislature should have power to authorize the units to impose a surcharge on any of the taxes in List III (Taxes leviable for the benefit of the units subject to a right of federal surcharge—such as taxes on personal income, death or succession duties, terminal taxes, commercial stamp duties, &c.) within such limits as it may think fit' (paragraph 107). Commercial opinion has already declared itself against the latter proposal.

There is less objection to another variant of this plan, which consists in the imposition of a single tax by the Government, whether Federal or State, which assesses and levies it, out of which a basic rate is allotted to the other Government concerned.

'Under this plan, so long as conditions are normal, the Government mainly concerned can vary its income without interfering with that of the other. It will be obvious, however, that if, for instance, in the case of a consumption tax, the total rate is increased to a point which diminishes consumption, the government which receives the basic rate may lose although the total return is increased.' (*Taxation Committee Report*, paragraph 512.)

Plan of division adopted by Percy Committee.

Income-tax has been selected for division, as was plainly the intention of the Peel Committee. The plan adopted is as follows:

	In lakhs.
Total gross yield of income-tax	18,00
Less cost of collection	80
Net yield	17,20
Super-tax on companies, tax on salaries of federal officers and personal income-tax and super-tax levied in Federal areas (to be retained by the Federal Government)	3,70
Balance available for distribution to the Provinces	13,50

Of this sum, about Rs. 2,00 lakhs represents collections of personal super-tax (i.e. other than company super-tax) and is distributed on the basis of actual collections from residents. Of the balance of 11,50, about one-seventh would approximately represent the estimated tax on the undistributed profits of companies and on the incomes of persons resident outside British India, and this is distributed on the basis of population. The remaining six-sevenths is distributed on the basis of the estimated share of

personal income-tax creditable to each Province. The exact distribution per Province is set out below:

(*Lakhs of Rupees*)

Province.	*2 crores on collections of personal super-tax.*	*$\frac{1}{7}$ of 11$\frac{1}{2}$ crores on population basis.*	*$\frac{6}{7}$ of 11$\frac{1}{2}$ crores on basis of personal income-tax without federal salaries.*	*Total.*
Madras . . .	7	30	1,46	1,83
Bombay . . .	50	14	2,79	3,43
Bengal . . .	1,10	32	2,63	4,05
United Provinces .	8	31	84	1,23
Punjab . . .	2	15	74	91
Bihar and Orissa .	18	24	65	1,07
Central Provinces .	3	10	46	59
Assam . . .	1	6	22	29
N.W.F.P. . .	1	2	7	10
Total . .	2,00	1,64	9,86	13,50

About 60 per cent. of the amount available for distribution goes to Bombay and Bengal, who have been asking so long for a share of the income-tax. The above plan is open to no objection on principle either—it is really based on the system of division of a tax into spheres, discussed above.

So far as the present writer is aware, nobody has objected to the above method of distribution on the ground of its unfairness as between Province and Province. The objection that has been raised is of a different kind altogether. It is directed to the surrender of income-tax to the Provinces in any shape or form. What is said is that at present the main heads of income of the Central Government are, customs, income-tax, and salt. Of these, the revenue from customs is diminishing steadily with the adoption of a protective tariff, and as the future Govern-

ment of India becomes more and more protectionist,[1] the income from customs will grow less and less, as imports will steadily be diminished. The salt revenue is already threatened and it may confidently be expected that increasing pressure will be brought on the future Government for its progressive reduction, if not entire abolition all at once. If, in these circumstances, 75 per cent. of the income-tax revenue is allotted to the Provinces, there will be nothing left for the Central Government to meet the many and grave responsibilities that will be placed upon it.

There is some force in the above argument, but it is equally necessary to give the Provinces larger resources of an expanding character, and nobody has been able to suggest how this can be done if income-tax is not surrendered. Sir Basil Blackett recently said that he was always a little in trepidation when he heard the suggestion made to hand over the income-tax to the Provinces. He thought that in an emergency such an arrangement would lead to a breakdown of the Government. But he admitted that the suggestion had great merits in that it gave the Provinces what they had certainly lacked hitherto, some reasonably elastic form of revenue on which they could justifiably go ahead with new developments. We may therefore leave the matter at that.

(*c*) *Contributions from Provinces to Federal Government or vice versa.*

Contributions from Provinces have been levied in the past but have always been regarded as a necessary evil. They have never been accepted as a permanent feature in Indian finance and their remission has always been kept in view. Under the Meston Settlement such contributions

[1] We have already dealt with this argument in Chapter III of Section II. The apprehension is altogether unfounded.

were paid for a certain number of years and discontinued when the financial position of the Government of India improved sufficiently. A similar levy is again being proposed for the benefit of the Federal Government, as a temporary measure at any rate. To the lay mind, it might seem confusing that on the one hand the proposal is that collections of income-tax should be distributed by the Centre to the Provinces, and on the other hand that the Provinces should make good the Federal deficit by cash contributions. Such apparent incongruities are, however, inevitable in making financial adjustments. Besides, shares of growing revenue and fixed cash payments do not have the same financial effect.

The difficulty in making such levies has always been that it is impossible to secure unanimity among the Provinces regarding the basis on which such contributions should be made by them. There are objections to almost any plan that can be adopted. Contributions may be based on:

(1) *Provincial expenditure.* This is calculated to recognize thrift and penalize extravagance, but will be objected to by the more advanced Provinces, whose scale of expenditure per head of population is comparatively high.

(2) *Provincial revenue.* This means increasing the taxation on those who are already most heavily taxed.

(3) *Provincial surpluses.* This is also unfair, as it takes into consideration both the highest scale of taxation and the lowest scale of expenditure. It penalizes the levy of high taxation for the common benefit as well as the exercise of thrift in the administration.

(4) *Population.* Such a levy would be unfair to the relatively poorer and undeveloped Provinces.

(5) *Increased spending power.* This method was adopted

by the Meston Committee. It is, however, regarded as the most unfair of all. It means a levy in proportion to the losses of half a century of provincial settlements.

Plan of provincial contributions proposed by Percy Committee.

As has been pointed out in Chapter III, the financial position of the Provinces as examined by the Committee was as below:

Province.	*Surplus (+) or Deficit (−) Rs. (lakhs).*
Madras	− 20
Bombay	− 65
Bengal	−2,00
United Provinces	+ 25
Punjab	+ 30
Bihar and Orissa	− 70
Central Provinces	− 17
Assam	− 65

With the distribution of income-tax as proposed by the Committee, the position of the Provinces would be as follows:

Madras	+1,63
Bombay	+2,78
Bengal	+2,05
United Provinces	+1,48
Punjab	+1,21
Bihar and Orissa	+ 37
Central Provinces	+ 42
Assam	− 36

With the exception of Assam, every Province would be in a happy position, if such an arrangement could be left undisturbed. But the Central Government could not afford a surrender of revenues to the extent of Rs. 13,50 lakhs which the above distribution involves. As will be gathered from Chapter III, the utmost it could give up was Rs. 500 lakhs. It thus became necessary to take back Rs. 850 lakhs from the Provinces.

It is at this stage that a scheme of cash contributions from the Provinces had to be devised. What do the Percy Committee suggest?

A return to the old Meston Committee plan of assessing the contributions primarily with reference to the additional resources of the provincial Governments—in other words, in proportion to their shares of income-tax.

The position of the Provinces would then be as indicated in the following table:

Contributions (in lakhs).

Province.	*Surplus (+) or Deficit (−) on the basis of present provincial revenues.*	*Share of income-tax.*	*Full contribution payable proportionately to the amount under col. 3.*	*Surplus (+) or Deficit (−) if full contribution is paid.*
1	2	3	4	5
Madras . .	− 20	1,83	1,15	+48
Bombay . .	− 65	3,22	2,03	+54
Bengal . .	−2,00	4,05	2,55	−50
United Provinces	+ 25	1,23	78	+70
Punjab . .	+ 30	91	57	+64
Bihar and Orissa	− 70	1,07	68	−31
Central Provinces . .	− 17	59	37	+ 5
Assam . .	− 65	29	18	−54

Three Provinces would be in deficit under the above plan. As no extra money is available, the Committee have recommended that 'the only method of relieving the deficit Provinces is to spread the charge over the other Provinces. The charge ought to be spread in proportion to the amount of income-tax received by each Province, but so as not to convert any of their surpluses into a deficit'. On this plan they propose a remission of 50 lakhs in the contribution of Bengal, 33 lakhs in that of Bihar and

Orissa, and 18 lakhs (the whole contribution) in that of Assam. The provincial position as thus revised would be as under:

Contributions (in lakhs).

Province	*Contribution payable*	*Contribution proposed*	*Final surplus*
Madras	1,15	1,41	22
Bombay	2,03	2,48	9
Bengal	2,55	2,05	nil
United Provinces . . .	78	95	53
Punjab	57	70	51
Bihar and Orissa . . .	68	35	2
Central Provinces . . .	37	37	5
Assam	18	nil	−36

No specific suggestion has been made by the Committee for wiping out the deficit of Assam, which has been left for joint consideration by the Government of India and the Government of Assam.

As regards the future, the Peel Committee recommended that the Constitution should specifically provide for the extinction of provincial contributions by annual stages over a definite period, such as ten or fifteen years. The Percy Committee, however, find it 'impossible to specify an annual rate of reduction of contributions or a definite period within which it could be anticipated with reasonable certainty that the natural growth of existing federal revenues, at the rates of taxation we have assumed, would enable the Federal Government to extinguish contributions altogether'. All that they suggest is that 'the aggregate contributions to be paid by the Provinces to the Federation should be a fixed sum which should be reduced gradually as and when the Federal Government can do so'.

Comments on the Percy Committee plan of provincial contributions.

As was only to be expected, this part of the Committee's work has been subjected to severe criticism, unlike its plan for distribution of income-tax.

The very fact of their adopting the Meston Committee formula of 'increased spending power' has set the Provinces against it. Well might Lord Meston repeat his gibe that the task is impossible, as it involves the filling of nine thirsty quarts out of a pint pot of revenue. A suggestion has been made that the contributions should, instead, be based half on population and half on total revenues. On theoretical grounds there is a great deal to be said in favour of such a plan, but it would not solve the problem of Bengal, Bihar and Orissa, and Assam.

The suggestion that some Provinces, in order to meet the deficit of others, should from the start be deprived of a substantial portion of the revenues allotted to them is regarded with great disapproval, and quite naturally so.

The absence of a time-table for the extinction of provincial contributions is contrasted with the recommendation of the Davidson Committee that a moiety of the cash contributions of the States should be extinguished at the latest in ten years from federation, and the whole within twenty years. If no time-table can be prescribed for the remission of provincial contributions, there should be none for the remission of the contributions from the States.

The present writer is convinced that so long as provincial contributions continue, the Federal Finance Minister will have no peace; resolutions will be moved every year in the Federal legislature recommending their remission; the comparative claims of remission of taxation and reduction of contributions, in the event of there being a substantial federal surplus, would be very difficult to

adjust; and what is not improbable is that relief may be granted, not so much on grounds of equity, as on political considerations.

It is therefore necessary, in the interest of stability and permanence, that this bone of contention between the Federation and its constituent units should be removed from the path at all costs. In the opinion of the present writer, it would be worth while trying to get this result, even by a proportionate reduction of the shares of income-tax to be surrendered to the Provinces.

Contributions from Federal Government to Provinces.

This is not at present a practical issue, as the question is how to balance a deficit federal budget under the proposed allocation of resources, but should the allocation of resources be changed substantially in favour of the Federal Government, so that, instead of its being left with a deficit it is left with a recurring surplus, and the Provinces with a recurring deficit, the question of making contributions from the Federal Government to the Provinces would arise. The difficulty of finding a suitable basis of distribution would in such a case also be very much the same as in the case of contributions from the Provinces to the Federal Government. Federal contributions in aid of the *general resources* (as distinguished from grants for specific purposes) of the constituent States are now paid only in Switzerland and Canada. In Canada the contribution consists of two parts, viz.:

(*a*) fixed allowances which vary for the different Provinces and are calculated on a scale sliding between a minimum and a maximum with reference to the population; and

(*b*) fluctuating allowances calculated on a *per capita* basis of population.

In some Provinces of the Dominion federal contributions constitute a very large proportion of the total revenue.

In Australia the Federal Government used to pay until recently contributions to the States on a *per capita* basis of population.

Experience of federations in other countries unmistakably shows that what is true of individuals is true of governments, viz. that it is wrong to give anybody money which he has not raised by his own effort, and consequently contributions from federal to provincial revenues or vice versa, for general purposes, should be avoided as far as possible.

Chapter VI

ALLOCATION OF LIABILITIES

THERE are only two classes of liabilities which require consideration:

(i) The National Debt.

(ii) Pensions.

The allocation to be made is between federal and central not between federal and provincial. So far as the Provinces are concerned, they already bear their share of the liabilities on account of the National Debt and Pensions respectively.

The National Debt.

The total interest-bearing public debt of India of all kinds outstanding on 31st March 1931 was about Rs. 1,173 crores. The recommendation made at the first session of the Round Table Conference was that 'the public debt of India on the date of the inauguration of the Federal Constitution should be a central subject'. The States were naturally unwilling to assume responsibility for debt raised prior to their association with British India and hence the allocation suggested above. When the matter was further considered, it was found that if such a suggestion was adopted, the pre-federation debt should be served only by income-tax collections, as there would be no other main head of central income, under the classification of subjects and the allocation of resources as agreed to. This would contravene the provisions of section 20 of the Government of India Act and also of East India Loan Acts under which the debt charges are secured on the whole revenues of British India, including those proposed to be classed as federal.

During the discussion of the subject at the meetings of

the Peel Committee, the States in their desire to advance the cause of federation modified their attitude slightly and agreed to the pre-federation debt being made a federal subject, provided they were satisfied that the whole of it was covered by assets that would be taken over. The Peel Committee did not agree with the view put forward in a memorandum by the Government of India Finance Department that 172 crores of the National Debt was uncovered by assets and was 'unproductive'. The question was referred to the Percy Committee for further examination. The Percy Committee have reported that 'if the Federal Government assumed responsibility for the whole of the pre-federation debt, its obligations would be covered by the assets also taken over', and that 'the service of the debt will be fully covered by the sources of revenue which will remain at the disposal of the Federal Government'.

It would be useless to go into details in a matter of this kind. Valuation of assets is always a very debatable question. Different results would be produced according to the basis adopted for valuation. It is not customary in Government departments to adopt any such valuation, and a valuation made with a specific end in view is always suspect.

Moreover, the term 'assets' would also require definition. If only such assets as yield a definite net return in the financial sense are included, the results would be different than when all assets, whether productive or unproductive (such as public buildings in non-commercial departments, built out of revenue), are taken into account. The Percy Committee seem to have included all assets, whether they bring in revenue or not.

In valuation of assets there are three possible methods:

(i) capital at charge;
(ii) earning capacity;
(iii) cost of replacement.

If (ii) were adopted to-day, the valuation would be very unfavourable, as owing to trade depression and fall in prices, most of the commercial departments (principally railways) are showing losses on their annual working. If (iii) were adopted, the cost at present-day prices would largely exceed the original outlay and there would be a considerable element of guesswork in a valuation of this kind.

The Committee have therefore adopted the only possible basis available in the circumstances, viz. the capital shown as debited to commercial departments in the statement of the public debt of India. The other departments also have been treated in the same manner, i.e. the value of their assets as shown in the departmental books has been accepted.

On this basis they work out the total value of the identifiable assets that would be transferred at Rs. 1063 crores. The public debt figure given above is taken at its nominal value. In it is included a very large amount on account of irredeemable loans raised at $3\frac{1}{2}$, 3, and $2\frac{1}{2}$ per cent. As these loans stand at a heavy discount nowadays, the capital liability that the Federation would take over would only be based on their market value. The Committee therefore urge for consideration that, so far as these loans are concerned, what the Federation would really be responsible for would be the nominal value minus a sum of about Rs. 145 crores. This would bring the figure of indebtedness within the value of the assets that would be transferred. This argument is not even highly plausible, for it can be said that if the Federation would assume only the responsibility for the market value of the loans raised, its assets also would be worth what they would fetch in the market, and not at what they stand in the official books. It is clearly not right to adopt market value as the

basis in the case of a certain class of liabilities, and not in regard to assets.

But it is true that in addition to the assets included in the Committee's calculation, there are others which cannot be included because figures are not available and would take a long time to compile. Hence there need be no hesitation in accepting the conclusion arrived at in favour of treating the entire pre-federation debt as a federal responsibility.

Pensions.

A pension is usually regarded as deferred pay, and is, therefore, like a provident-fund bonus, a liability arising during the service of an officer. It is, however, not the practice to reserve in advance for a pensionary liability, but to regard a pension as a legitimate charge against the revenues of the future. Consequently, any party appropriating a part of future revenues should assume responsibility for a corresponding proportion of the pensionary liability of the past. Applying this principle, pensions of officers who were previously employed on duty which in future would fall within the scope of federal activities, should be a federal charge. Pensions of officers not so employed should be a British India or 'central' charge.

The Percy Committee, however, think that the application of this principle in practice would necessitate an expenditure of labour out of all proportion to the amount involved, which will necessarily go on diminishing. They calculate that out of a total charge for pensions, amounting to over Rs. 2½ crores per annum, the 'central' liability amounts to only Rs. 80 or 90 lakhs, and as the Federation would be retaining out of the receipts of income-tax—a purely 'central' head of income—a much larger sum than this, there is no need to insist on treating such pensions as a 'central' charge. This is reasonable.

Chapter VII

BORROWING

THERE is a strong argument in favour of giving full freedom to the Provinces in regard to borrowing.

So long as the Provinces are spoon-fed by the Central Government, they naturally feel that they can look up to that Government to pull their financial chestnuts out of the fire. But once they are thrown upon their own resources, and find that if they mismanage their finances their credit deteriorates and they cannot get any loan from the public, they will have the strongest inducement to pursue a sound financial policy.

This is to a large extent true, but does not by itself settle the question which is a somewhat complicated one. The credit of the country as a whole is involved and even though the Federal Government may have no legal liability its moral liability would still be there, and so far as non-Indian bondholders are concerned, they would look to the National Government of the country for redress in case of default by a Province. In addition, provincial revenues are already hypothecated for the existing National Debt, as well as for the loans taken by Provinces from the Provincial Loans Fund. It is, therefore, impossible to give such liberty in borrowing to Provinces as would either:

(i) affect the credit of the country as a whole; or
(ii) diminish the security of holders of existing loans, or
(iii) diminish the security on which loans have been taken from the Provincial Loans Fund.

In spite of the present strictly limited powers of borrowing by the Provinces, and their political subordination

to the Central Government, the Central Public Accounts Committee has recently brought to light cases in which provincial Governments have not paid interest for portions of loans taken by them from the Central Government. The loans already raised by some Provinces for purposes of 'development' yield no net return and are really a drain on their general revenues. As recently reported by the Auditor-General, the Bombay Government has been meeting its ordinary expenditure out of borrowed money, and its burden of debt is so heavy that it finds itself unable to provide for the amortization of a large portion of the post-reform borrowings and for the amortization also of large future borrowings which are stated to be inevitable. Sir George Schuster, in a debate in the Legislative Assembly on 15th February 1932, stated that the question of control of loan policy was

'one of the most important questions in the whole field of finance. Many countries in the world, in spite of balancing their budgets, have come to trouble owing to commitments of capital expenditure on unwise programmes. Some machinery would have to be devised by the Government of India to scrutinize the schemes for capital expenditure before money is lent to the provincial units, for the reason that if the scheme is of such magnitude as seriously to affect the financial position of the borrowing Province then it must be scrutinized beforehand.'

In formulating proposals for the future, we may either consider giving the Provinces separate statutory powers, under certain restrictions, or vesting all borrowing powers —both for the Centre and the Provinces—in a single body. In India, to a certain extent, both the methods are now in operation, and we are thus able to form a judgement regarding their respective suitability or unsuitability.

The statutory powers of borrowing of provincial Governments are derived from section 30 (1 A) of the Government of India Act and the Local Government Borrowing Rules made there-under. Under these Rules, a provincial Government may raise money *on behalf of the Secretary of State in Council*, on the security of revenues allocated to it,

(*a*) in India, with the sanction of the Governor-General in Council,
(*b*) outside India, with the sanction of the Secretary of State in Council;

for certain specified purposes and on terms approved by the Governor-General in Council for a rupee loan, and by the Secretary of State in Council for a sterling loan. Practically speaking, there is not much freedom of action to provincial Governments in the matter. No loan has yet been raised by any provincial Government outside India. In India, so far, only three provincial Governments, viz. of Bombay, United Provinces, and Punjab have raised direct loans for development purposes, the total of which amounts to Rs. 17 crores.

There are three drawbacks in letting Provinces raise public loans:

(i) Experience shows that the Provinces, with their comparatively limited credit, have to pay more in this manner than if they take advances from the Government of India. This was the experience of the States in Australia also, which eventually led to the centralization of all borrowing powers in the Australian Loan Council.

The following statement shows that, as a result of the exercise of their statutory powers of borrowing, the Provinces are suffering an annual loss of nearly Rs. 10 lakhs.

Provincial loans	*Amount in lakhs of rupees*	*Effective rate of interest per cent.*	*Rate of interest on the Government of India loans in the same year*	*Difference in interest per cent.*	*Net loss per annum in the shape of interest in lakhs of rupees*
The Bombay Development Loan, 1920 .	9,39	7·13	6·57	0·56	5·26
The United Provinces Development Loan, 1921 . . .	4,20	7·36	6·57	0·79	3·32
The Punjab Development Loan, 1923 .	1,92	6·26	5·88	0·38	0·73
The Punjab Development Loan, 1925 .	89	5·76	5·48	0·28	0·25
				Total	9·56

All the loans above have, as it will be observed, been raised between 1920 and 1925. Since 1925 a Provincial Loans Fund has been established by the Government of India, and though the statutory powers of borrowing by provincial Governments are still in existence they have not been used, as Provinces find it cheaper to take advances from the Provincial Loans Fund rather than approach the market directly.

(ii) The money market in India is confined to two cities only, Bombay and Calcutta, and other Provinces are at a disadvantage in floating loans as compared with Bombay and Bengal.

(iii) The Central Government and the Provinces competing against one another in a limited market would spoil it for everybody.

The Provincial Loans Fund, established since 1925, is worked on the principle that if a provincial Government makes suitable arrangements for the payment of interest and amortization, money will be made available from the Fund to the full extent of the Province's requirements. The Government of India normally refrains from scrutinizing the purposes for which loans are required by a Pro-

vince, the selective influence being provided by varying the terms of interest and repayment according to the object for which the money is borrowed.

It is this abstention on the part of the Central Government in the matter of scrutiny of the objects for which applications for loans are made that has led to the evil results referred to by Sir George Schuster, and it is clear that whatever central body is created under the new Constitution, it must be empowered to exercise this scrutiny and reject loan applications, whether from the centre or from the Provinces, for objects not approved of by it.

A careful study of the two alternatives discussed above clearly points to the need of a central co-ordinating authority which would deal justly with the requirements of each. The example of Australia in the matter is a very good guide. All the States, realizing a common need, gave up their independent borrowing powers and vested them in a Central Loan Council, which is now the sole authority for the conduct of borrowing operations for the Federal Government as well as the States. A similar body consisting of *experts* might be set up in India with more or less similar functions and powers. Such a body would go through the borrowing programmes of the Federation and its units, and apportion the amounts to be raised by each (in India or outside India), for purposes and on terms which would have to be approved by it. The loan thus approved would subsequently be raised by the Government concerned on the security of its own revenues, *subject to the sanction of the legislature.* Or, in other words, the objects and terms of a loan must be administratively approved by the Central Loan Council before the sanction of the legislature is sought. The legislature may refuse to grant sanction to the issue of a loan, but may not modify its terms or purposes as approved by the Council.

The Percy Committee are of opinion that each unit should have the right of independent borrowing, subject to its giving the Federal Government notice and an opportunity to offer advice. If, however, a unit has loans outstanding with the Federal Government (whether or not such loans were raised before the date of federation), its right of independent borrowing should be regarded as in abeyance, and it should be obliged to obtain the consent of the Federal Government for any further loan which it desires to raise.

The above recommendation safeguards the credit of the country and should be accepted. It is clearly worded so as also to safeguard the existing rights of the States with regard to independent borrowing. As practically every Province is indebted to the Provincial Loans Fund, the right of independent borrowing conceded above would be more nominal than real.

Further, as it is unthinkable that the Federal Government would let any Province reach the stage of financial chaos, some provision must be made in the Constitution to ensure that every constituent unit pays its debts. Recently, the Commonwealth Government in Australia was obliged, by the refractory attitude of the Lang Government of New South Wales, to acquire power to seize the revenue of a defaulting State, and give bondholders direct rights against the Commonwealth. It is unnecessary to describe the procedure in detail, for the Statute in question was passed only in March last, and attracted a great deal of public notice. We should hope such a contingency would never arise in India, but it is always best to be armed with reserve powers, and the advisability of providing some such safeguard in the Constitution is clearly indicated.

Chapter VIII

ACCOUNTS AND AUDIT

Accounts.

UNDER the present system the public account in India is one, and is under the control of the Governor-General in Council. The Provinces have no separate public account. When they become autonomous they will have their own provincial revenue funds, into which will flow all the proceeds of provincial taxation and other receipts, and out of which all provincial disbursements will be met. The compilation of provincial accounts will be a provincial subject, to be paid for by the Province concerned, and it will be for each Province to decide whether it would wish to take advantage of the present centralized service of the Indian Audit and Accounts Department, or would prefer to make its own arrangements. From the replies received from provincial Governments in connexion with the recommendations of the Simon Commission on the subject, it does not appear that they are keen on having separate account departments and account services of their own. All of them agree that the Central Government should continue to keep the provincial accounts, and charge the Provinces with the cost involved. Should at any time separate provincial accounts departments come into existence, it would still be necessary to arrange for the preparation of accounts and the collection of financial statistics for the whole of India on a uniform basis.

Audit.

At present, the Auditor-General in India is responsible for the audit of all *expenditure in India*, whether central or provincial.

With provincial autonomy this position may change to a very great degree. Instead of one central audit, there may be an audit department in each Province, with an Auditor-General responsible to the provincial legislature, and entirely independent of the provincial executive. The change from the present position would be very great, but it would only be a natural consequence of the introduction of provincial autonomy. The position of an audit officer is akin to that of a judicial officer, and if the Provinces can have their own High Courts of Judicature, there is nothing inherently absurd in their having their own audit departments. That they may not wish to do so is entirely a different matter. As far as can be gathered, there is no inclination to dispense with the services of the centralized Indian Audit Department.

Whether the Provinces have their own audit services or use the present agency, they will have to bear the cost of their own accounts and audit. The Percy Committee have assumed this in preparing the federal and provincial budget forecasts discussed in Chapter III. The Provinces will have to pay Rs. 60 lakhs in all for these departments.

Chapter IX

CASH BALANCES

THE Government of India at present acts as banker for the Provinces, and the cash balances at the credit of provincial Governments and the Government of India are merged into one consolidated account. No Province has any rights or liabilities of its own; each acts on behalf of the Secretary of State in Council, who alone, under the Government of India Act, is empowered to sell, mortgage, and buy property, to make contracts and to sue and be sued as a body corporate. When federation comes into being all this will change: each Province will possess a separate political entity, and therefore a separate juristic personality. The separation of provincial balances from those of the Central Government is an essential feature of the grant of provincial autonomy, and follows inevitably from the separation of provincial from central accounts. With the separation of balances the provincial Governments will also take over the responsibility for financing their own ways and means programmes, and keeping the local administration in funds from day to day—a responsibility which is now discharged for them by the Central Government, as the custodian of the public account and of Government balances throughout British India.

The position of the Provinces *vis-à-vis* the Federal Government regarding accounts, audit and cash balances will be generally similar to that of an Indian State, like Hyderabad or Mysore, which is self-contained in regard to these matters, so far as the Government of India is concerned.

Chapter X

THE ECONOMIC CASE OF THE INDIAN STATES

THE economic grievances of the Indian States are of a very long standing and date practically from the beginning of the British connexion with India. Under the policy of isolation enforced on the States by the British Government, Princes were debarred from exchanging ideas among themselves, and formulating views on questions affecting them as a body. The formation of the Chamber of Princes gave them this opportunity for which they had long been representing, and eventually they succeeded in getting a Committee of Inquiry which was presided over by Sir Harcourt Butler. The Butler Committee did not give the States the relief they were seeking, or else the history of the Round Table Conference would have been written differently, but it served one good purpose. It revealed for the first time to the British public as well as to a large number of British Indian politicians that the Indian States had serious economic (and political) grievances against the Government of India, and that they were determined to have them redressed. It is utterly impossible to do justice within a few pages to a case that was discussed at eighteen long sittings of the Butler Committee, and occupies several thousand printed pages of the evidence submitted to that Committee. An attempt will, however, be made to indicate very briefly some of the broad features of the general case of the States, as affecting the question of Federal Finance.

The majority of the Indian States form an almost continuous chain of land-locked territories with no important seaports of their own. There are, of course, a few maritime States, but they are not allowed by the Government of

India to develop their ports to anything like the extent of their natural capacity, or to supply more than purely local needs. The Government of India is, therefore, in a position to levy customs duties at its own ports on goods intended for the territories of Indian States. The States are debarred from levying transit duties on goods passing through their territory, but the Government of India actually levies transit duties on goods passing through its territory from a seaport to an Indian State.

In relation to excise duties, it is a well-known rule of financial policy that the incidence of such taxes should follow consumption. The Government of India does not, however, observe this rule in relation to Indian States and levies excises on salt, petroleum, kerosene, silver, and intoxicants produced in British India but consumed in Indian States. The States complain that:

(1) they have no voice in the imposition of such taxation;
(2) they get no financial benefit from such taxes as they are used entirely for the benefit of British India;
(3) the imposition of such taxation leaves the Governments of the States with inadequate resources for their own economic development, which is most urgent.

The States cannot resort to direct taxation to meet their needs as is done in British India, as they have no taxable middle class yet.

In relation to commercial undertakings, such as Railways, Posts and Telegraphs, the Government of India, it is alleged, forces the States to grant concessions and appropriates the profits. The amount which the States contribute under these and other heads to the revenues of British India will be given in another paragraph. But this does not exhaust the tale of their grievances.

It is understandable for a Government to say that it is entitled to derive the fullest advantage from its geographical

position or from any monopoly which may be the result of its own enterprise. On this ground the imposition of sea customs, irrespective of the ultimate destination of the goods, can with some show of justification be defended. Similarly, for purposes of argument, it can be maintained that as articles like kerosene oil, intoxicants, &c., are produced in British India, British India has every right to tax them, as nobody compels the States to buy such articles from British India against their will. But if the Government of India claims such freedom for itself it must allow equal liberty of action to the States. This it unfortunately does not permit. Not only does it take such action as it likes in British India without consulting the States, but it also requires the States to take within their own territory action prejudicial to the economic interests of the subjects of the States, and even to sacrifice revenue in furtherance of the financial interests of British India. For instance, what justification can there be for compelling the States which are allowed a certain quantity of salt for their own consumption, to raise the price at which they sell salt to their own people, whenever the salt tax is raised in British India to suit the exigencies of the Government of India budget. Again, the States are compelled to follow the excise policy of adjoining British Indian Provinces, without any reciprocal obligation of co-operation on the part of the Provinces. If a Province wishes to raise its rate of duties, the neighbouring States must also raise theirs, but if a State raises its duties the adjoining Provinces are not bound to do so. If it is desirable to prevent smuggling from the States and protect the revenues of British Indian Provinces, it is equally desirable to prevent smuggling from British India and protect the revenues of the adjoining Indian States. Similarly, in regard to opium, several States which produced large quantities of opium were

compelled to reduce the cultivation of opium within their territories, which entailed severe hardship on their subjects, but they got no benefit from the duties levied on their opium exported under the control of the Government of India. If the co-operation of the States in the restriction of opium cultivation was desirable, in view of India's international obligations, justice required, first, that the restriction of cultivation in British India and the Indian States should have been fixed on a *pro rata* basis and secondly, that the profits from the monopoly should have been shared between the Indian States and British India in proportion to the quantity of opium respectively exported by them.

Dissatisfaction with such one-sided policies and measures was only to be expected. It is, therefore, no wonder that the States in their desire to put an end to a system which renders such a state of things possible should be so eager to federate with British India and secure a voice in the formulation of policies relating to matters of common concern. In fact, the main advantage of the Federation to the States will be on the economic rather than on the political side, as the Federation will have no concern with matters of internal administration of the States or questions affecting paramountcy.

With their entry into the Federation, the States will contribute to the federal fisc through indirect taxation in the same manner as the Provinces, and consequently there will remain no foundation for their present-day claim to a share of indirect taxation imposed by the Central Government or to any profits accruing from Currency, Railways, Posts and Telegraphs, &c. So far as the contribution of the States to provincial revenues, through excise duties or any other item, is concerned, the question would still require adjustment. The abandonment of such a claim

whether on central or provincial revenues must, however, be contingent on present injustices being remedied. The recent publication of the Report of the Davidson Committee enables a more authentic presentation of facts and figures than was previously possible. The manner in which however this important question has been handled is one which might give cause for dissatisfaction to the States. When the States asked for redress at the hands of the Butler Committee, they were told that the working out of credits and debits under each head was much too complicated a matter and that another expert Committee was necessary. That expert Committee was never appointed. Under the terms of their reference, the Davidson Committee were permitted to consider matters 'not specifically mentioned in their terms of reference, but which have so close a bearing upon the matters remitted to them that they cannot, in the Committee's view, be disregarded'. Under the latitude thus given, the Committee have made recommendations regarding certain economic grievances of the States, but only such as involve 'a measure of immunity from contribution to central revenues' in regard to certain prospective federal subjects'. They have disclaimed any idea of regarding themselves as the expert Committee which was contemplated in the Butler Report. Such being the case, they ruled out of order many claims put forward by the States (paragraph 11 of the Report), and perhaps no other opportunity for their consideration would now arise. Again, the contribution made by the States to Imperial Defence has not been examined, and this naturally puts certain States with military traditions, like Kashmir, at a great disadvantage, in that they appear to enjoy immunities without a *quid pro quo*. It is only when the whole economic case of the States is comprehensively reviewed that any opinion can be formed whether

the States would or would not be contributing to 'common burdens' on a basis of equality. In the meanwhile, the broken manner in which certain aspects of their case are presented to the public gives British India ground for accusing the States of selfish motives: grabbing everything and giving nothing.

The Economic Contribution of the States to all-India Revenues.

The contributions of the States, direct and indirect, to all-India revenues fall under the following categories:

(1) indirect contribution;
(2) cash payments or tributes and subsidies;
(3) cession of territory as price of military protection; and
(4) maintenance of troops for Imperial purposes.

Indirect Contribution. This aspect of the question was examined by a special Committee appointed by the Government of India in August 1930, whose findings briefly are as follows:

(*a*) *Sea Customs.* On the basis of the Customs tariff then in force,[1] the Committee worked out that the duty accruing to central revenues from the consumption of imported articles in the States amounts to Rs. 598 lakhs, minus cost of collection at 14·4 per cent. or Rs. 512 lakhs.

(*b*) *Excise.* The excise revenue is of two classes:

(i) Provincial excise on liquors, drugs, and narcotics;
(ii) Central excise on petrol, kerosene and silver.

According to the Committee the share of provincial excise revenue contributed by the States is Rs. 15,35,000. The share of Central excise revenue is:

Petroleum	Rs. 20,00,000
Kerosene	23,19,000
Silver	4,53,000
Total	Rs. 47,72,000

[1] The tariff has been considerably increased since then.

(*c*) *Salt Revenue.* At the rate of duty current in 1930[1] the credit to States under this head amounts to Rs. 1,11,20,000 minus cost of collection at 19·75 per cent. or net Rs. 89 lakhs.

The Committee did not go into the question of currency and railway profits, but it is well-known that substantial amounts are credited to central revenues under these heads and a fair share of these profits is derived from the subjects of the Indian States.

(*d*) *Currency Profits.* The profits from currency arise under two heads, metallic currency and paper currency.

(1) The Gold Standard Reserve represents the accumulation of the profits of the coinage of the Indian rupee, which is also current in the majority of the States. The interest on the investments in the Gold Standard Reserve is credited to the revenues of the Government of India, and it must be admitted that some portion of this interest is creditable to the States. On the population basis, 22 per cent. of the profits from rupee coinage would be the share of the States. On the basis of the figures for 1928–9, this would amount to Rs. 39.7 lakhs.

(2) The interest on the investments in the Paper Currency Reserve is also credited entirely to the revenues of the Government of India. As a fair share of the Government of India paper currency is in use in the Indian States, some portion of this revenue must be realized from such use.

It may be assumed that as the States are not so highly developed as British India, the use of paper currency in the States is not more than half that of British India, per unit of population. On this basis the share of the States in the profits from paper currency (on the basis of the figures 1928–9) would be 11 per cent. of the total profits, or Rs. 11.5 lakhs.

[1] The duty has since been increased.

(*e*) *Railways.* The share of the railway profits due to earnings from traffic in passengers and goods from Indian States is not authoritatively known but has been estimated at Rs. 47 lakhs.

The total indirect contribution of the States would thus amount to:

	Rs. (lakhs)
Customs	512
Excise	63
Mint and Currency	51
Salt	89
Railways	47
Total	762

Cash payments or Tributes and Subsidies. Payments under this category amount to Rs. 73,50,000. The objects for which these payments are made are, generally, protection and maintenance of troops.

Cessions of Territory to pay for Military Protection. The valuation of the ceded territories (by certain States, not all have ceded territories) by the special Committee is given below, separately in regard to each State:

	Revenue	*Expenditure*
Hyderabad	2,45,19,600	1,76,12,900
Baroda	1,04,02,900	71,78,400
Gwalior	81,80,800	58,21,300
Indore	12,18,000	Not fully known
Sangli	3,40,200	2,73,000
Total	4,46,61,500	3,08,85,600
Net revenue		1,37,75,900

Maintenance of State Troops for Imperial Purposes. The expenditure incurred by the States, as worked out by the special Committee, is as follows:

(1) Indian State Forces	Rs. 2,38,71,000
(2) Other military expenditure	Rs. 1,60,00,000
Total	Rs. 3,98,71,000

Say Rs. 4 crores, roughly.

Expenditure on Indian State Forces must obviously be for Imperial purposes.

Common Burdens. While it is comparatively easy to prepare the credit side of the account of the States, the preparation of the debit side, or the assessment of the contribution of the States to common burdens, is one of very great difficulty. Two points arise for determination:

(1) What are really common burdens?
(2) What should be the principle governing apportionment of expenditure in common burdens as between British India and the States?

A rough and ready criterion for the inclusion of items in the list of common burdens would be furnished by the list of Crown and federal subjects as may be finally agreed to. Expenditure on such items would be debitable to the States as well as British India.

Once agreement is arrived at on the items of common expenditure, the share to be borne by the two parties must be governed by the extent of the interest of each in the purposes served by the expenditure in question. This must obviously vary with different items and must be determined on the merits of each case.

When the States were expecting the appointment of the expert Committee adumbrated in the Butler Report, they employed an expert who had just before occupied a high position in the service of the Crown in India, for the preparation of their economic case. He went into the matter in great detail and according to him the share of common burdens, including the charges borne by the States on Indian States Forces only, is roughly as below:

	Rs. (*lakhs*)
Share of civil Imperial burdens	64
Share of cost of foreign defence	180
Share of interest on War Debt	111
Total	355

The account of the States *vis-à-vis* British India stands thus:

Credits	*Rs. (lakhs)*	*Debits*
Indirect contributions	7,62	
Tributes	73·50	
Cessions of territory (Net revenue.)	1,37·75	
Total Credits	9,73·25	Total Debits *Rs.* 355 *lakhs*

Net Credit, *Rs.* 618·25 *lakhs*.

Or, in other words, the States pay roughly Rs. 6 crores per annum more than can justifiably be claimed by British India from them. Against the above, what relief do they get from the recommendations of the Davidson Committee. As explained in Chapter III of this section, 50 lakhs immediately and Rs. 1 crore ultimately. In these circumstances, is there any justification for asking for a further contribution from them, as British Indians sometimes ask, in respect of:

(i) sea customs, by taking away their present rights in regard to land and sea customs;

(ii) income-tax, by subjecting them to a levy at the same rates as in force in British India; or

(iii) proposed excise on matches, which would take half a crore from them annually.

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